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No.

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1990

BORMAN'S, INC.,
Petitioner,

v.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. Does rule 52(a) of the Federal Rules of Civil Procedure apply to findings of fact made by a district court in a trial involving a constitutional question?

2. Did the Court of Appeals err in reversing the District Court which found, following a trial, that a statutory standard is unconstitutional as a violation of the right to equal protection because the standard is meaningless and is thus arbitrary and not rational?

3. Did the Court of Appeals violate rule 52(a) of the Federal Rules of Civil Procedure in reversing the District Court's factual findings, made after a trial, without holding that the findings were clearly erroneous?

LIST OF PARTIES AND RULE 29.1 LIST

The parties to the proceedings below were the petitioner and respondent.

The petitioner is Borman's, Inc. ("Borman's"). Borman's is a wholly owned subsidiary of The Great Atlantic & Pacific Tea Company, Inc. At the time of the trial, Borman's was a public company. It became a wholly owned subsidiary in February, 1989.

The respondent is Michigan Property & Casualty Guaranty Association ("Association"). Association is not a subsidiary or affiliate of any publicly owned corporation. However, by statute, its members are (with limited exception) all insurance carriers authorized to transact business in Michigan, many of which are publicly held corporations or subsidiaries or affiliates of publicly held corporations.

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OPINIONS BELOW

The opinion of the Court of Appeals for the Sixth Circuit is reported at 925 F.2d 160 and is reprinted in the Appendix beginning at A-1.

The opinion of the United States District Court for the Eastern District of Michigan (Hackett, D.J.) is reported at 717 F. Supp. 480 and is reprinted in the Appendix beginning at A-19. The District Court's opinion was modified by three orders: Order Amending Judgment and Opinion dated July 31, 1989; Order Granting Defendant's Motion to Amend Findings dated July 31, 1989; Order Amending Order Amending Findings dated August 29, 1989. These orders are reprinted in the Appendix beginning at A-11.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on February 7, 1991. On February 19, 1991, plaintiff timely petitioned for rehearing and requested rehearing en banc. On March 25, 1991, the Sixth Circuit denied the petition for rehearing. Appendix at A-10. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

U.S. Const. Amend. XIV, §1.

This case involves the Michigan Property & Casualty Guaranty Association Act ("Act"). Mich. Comp. Laws §500.7901 *et seq.* Petitioner specifically challenged the following section of the Act:

> Covered claims shall not include obligations to an insurer, insurance pool, underwriting association, or to a person who has a net worth greater than 1/10 of 1% of the aggregate premiums written by member insurers in this state in the preceding calendar year.

Mich. Comp. Laws §500.7925(3).

Other statutory provisions referred to in this petition are reprinted in the Appendix beginning at A-43.

STATEMENT OF THE CASE

In this case, the District Court conducted a trial to determine whether a Michigan statutory provision was rationally related to a legitimate governmental purpose. After seven days of trial, the District Court issued detailed findings of fact and conclusions of law in which it found that the statutory classification was irrational and arbitrary and thus violated the equal protection clause of the Fourteenth Amendment. The Sixth Circuit Court of Appeals ignored the District Court findings and decisions of this Court and reversed the District Court.

Under the Michigan Property and Casualty Guaranty Association Act ("Act"), a fund is created to pay claims that arise under policies issued by insurers who become insolvent. Mich. Comp. Laws §500.7901 *et seq.* The Act was drafted by an insurance industry trade association and the general counsel of about five major insurance companies whose efforts were directed to protecting the interests of the insurance companies.

In essence, the Act provides substitute coverage to insureds and claimants in the event of an insurer's insolvency. Once an order of liquidation is entered against an insurer, the Michigan Property and Casualty Guaranty Association ("Association")

steps into the insurer's shoes to defend, settle and pay claims. Mich. Comp. Laws §500.7941(4). *The Association's interests are the interests of private insurance companies.* With limited exception, the Association is comprised of all insurers authorized to transact insurance business in Michigan. Mich. Comp. Laws §500.7911(1). The Association is managed by a board of governors consisting of five member insurance companies and two persons representing the general public. Mich. Comp. Laws §500.7912.

The fund moneys are not State or governmental revenues and are not tax dollars. The fund consists of assessments levied on insurance companies equal to a portion of the premiums that they collect from policyholders. Mich. Comp. Laws §500.7941(1)(4). The assessments are charged per category of insurance and may only be used to pay claims and costs associated with the particular category for which the assessment is collected. Mich. Comp. Laws §500.7941(2). Thus, the payment of claims under the Act is from funds provided by assessments against the insurance carriers and, to the extent the assessments are passed on, the insureds bear the cost of claims of their respective category through their premiums. Insureds who pay higher premiums pay more assessment dollars. The amount of a covered claim is limited by the amount of coverage afforded under the policy and the maximum claim limit described in the Act. Mich. Comp. Laws §500.7925(4)(5).

While the purpose of the Act is to protect insureds and their victims in the event of insurer insolvency, insureds and victims (including insureds who have paid assessment dollars via their premiums) who have a net worth in excess of a statutory formula are excluded from its protection. Mich. Comp. Laws §500.7925(3).

Borman's, Inc. ("Borman's") was insured by a carrier that was later declared to be insolvent. After the Association denied Borman's claims for protection under the Act on the basis of the net worth provision, Borman's filed this action seeking a declara-

tory judgment and monetary relief.[1] Borman's challenged the net worth provision as violating its rights to due process and equal protection under the Constitution of the United States. U.S. Const. Amend. XIV. The United States District Court for the Eastern District of Michigan denied cross motions for summary judgment, holding that the issue of whether the net worth provision is rationally related to a legitimate State purpose, required factual development. Appendix at A-40.

Following a bench trial, the District Court issued an opinion (containing detailed findings of fact and conclusions of law) holding that the net worth provision violates Borman's right to equal protection. The opinion and judgment were amended by orders entered on July 31 and August 29, 1989. Appendix at A-11 through A-18. With the exception of Borman's claims, the District Court applied the judgment prospectively by limiting its

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[1] Borman's is the owner and operator of a supermarket chain. For the period from May 1, 1980 to May 1, 1984, Borman's primary general liability and auto insurance carrier was Ideal Mutual Insurance Company ("Ideal").

On September 24, 1984 (more than four years after Borman's purchased the Ideal policy), a judgment on a jury verdict was entered against Borman's for in excess of $2 million for an accident which had occurred in 1980. The judgment was covered under the Ideal policy. Ideal agreed to pay at least $950,000 toward settlement of the judgment, however Ideal was then declared insolvent and paid nothing (Tr 1/9:47). (References are to the date and page of the trial transcript.) As a result of Ideal's failure to pay, Borman's was required to pay Ideal's share of the settlement (Tr 1/9:53). Numerous other lawsuits and claims have been asserted against Borman's for alleged injuries occurring during the period of the Ideal policies.

Ideal was a solid company at the time Borman's purchased the insurance. *Best's Key Rating Guide* ("Best") is the most commonly used source in the insurance industry for rating the financial condition of insurance companies (Tr 1/11:100-101). *Best's* specialty is to investigate insurers "to determine whether these insurance companies are in good financial condition" — it is the "industry bible" (Tr 1/11:100-101). *Best* gave Ideal high ratings during the policy years in question.

In addition, the Michigan Insurance Bureau, which monitors the financial status of insurance companies doing business in Michigan, was satisfied that Ideal was not a risk to the public based on the 1980, 1981 and 1982 financial information and the follow-up information that the Bureau requested from Ideal. The Bureau did not impose restrictions on Ideal until August 17, 1984.

application to claims filed with the Association arising under policies issued by insurers who are declared insolvent after the date of the court's opinion. 717 F. Supp. at 479-480, Appendix at A-37 through A-39.

The District Court found that the purpose of the net worth provision is to allocate loss to those best able to absorb loss and that net worth is not rationally related to this purpose. The District Court considered the evidence presented at trial and made no assumptions that it knew what a net worth figure indicates.

The District Court opinion was based on the uncontroverted facts presented at trial. These facts established that net worth is a line item on a financial statement which standing alone has no meaning and is not indicative of financial condition or the ability to absorb loss.

The Association appealed the District Court decision. It did not appeal the denial of its motion for summary judgment. On February 7, 1991, the Sixth Circuit Court of Appeals reversed the District Court in an opinion which failed to give the required deference to the District Court's findings and improperly utilized a *de novo* standard of review of the District Court's factual findings. 925 F.2d 160, Appendix at A-1. On March 25, 1991, the Sixth Circuit denied rehearing and rehearing en banc. Appendix at A-10.

Evidence relating to the passage of the Act was introduced at trial. The original House Bill was introduced on April 15, 1969. Between April 15, 1969 and May 2, 1969 (when a substitute bill was introduced) about five general counsel of major insurance companies were invited to sit on a committee along with an actuary from the Michigan Insurance Bureau ("General Counsel's Committee"). The General Counsel's Committee was not a legislative committee. It was asked to "discuss the probability of a Guaranty Fund Bill" (Tr 1/13:21-22).[2]

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[2] References are to the date and page of the trial transcript.

Elijah Poxson, who has been both President and General Counsel for Michigan Mutual Insurance Company ("Michigan Mutual"), was a member of this General Counsel's Committee. Poxson was employed by Michigan Mutual for over 35 years from 1941 through 1977, when he took an early retirement (Tr 1/13:8-9).

In its opening statement, the Association represented that Poxson was a "drafter of the Act" and that he would testify that "one of the things explicitly discussed was that consideration should be given to the comparative capacity of [a] policyholder and a claimant to absorb a loss. It wasn't something that just happened to slip into the statute without any thought by anybody" (Tr 1/9:28-29). However, contrary to the Association's representation, Poxson's testimony makes clear that the General Counsel's Committee hardly discussed the net worth provision, and that the meaning of net worth and what a net worth figure indicates were not considered.

Poxson testified only as to his participation on the General Counsel's Committee. There was no evidence presented at trial of any legislative consideration. Poxson testified that during much of his employment with Michigan Mutual, he participated in the American Mutual Insurance Alliance ("Trade Association"), a national trade association for insurance carriers (Tr 1/13:10). According to Poxson, the Trade Association monitors legislation, attempts to affect the course of legislation and participates as amicus curiae in litigation affecting the insurance industry. *In other words, the Trade Association lobbies legislatures and attempts to influence courts to make decisions in favor of the interests of insurance companies* (Tr 1/13:10, 54).

In the late 1960s, Senator Magnuson proposed federal legislation to create a national fund to deal with insurance company insolvencies by pre-insolvency assessments. The insurance industry was opposed to federal legislation (Tr 1/13:20). In an effort to thwart the federal legislation, the legal committee of the Trade Association appointed a subcommittee, of which Poxson was a member, to draft a model bill for state regulated post-insolvency

assessment legislation (Tr 1/13:20, 56). The subcommittee drafted a proposed bill that had a net worth limitation of $1 million at the time of the insured event and a maximum assessment of 1% of net direct annual premiums written (Tr 1/13:67).

The original bill introduced in the Michigan legislature did not have a net worth provision. Sometime between April 15, 1969 (when the original bill was introduced) and May 2, 1969 (when the substitute bill was introduced), the General Counsel's Committee met. Poxson testified that he reviewed the proposed bill and did not like it (Tr 1/13:22, 24-25). Poxson then obtained a copy of the Trade Association subcommittee's draft bill and gave it to the actuary member of the General Counsel's Committee to be used as a substitute bill (Tr 1/13:25). The actuary then called another meeting of the General Counsel's Committee to discuss Poxson's (i.e. the Trade Association's) proposed substitute bill (Tr 1/13:25). The actuary devised a formula which, based on the aggregate premiums for 1968, came out at approximately $1 million and substituted the formula for the flat $1 million provision contained in the Trade Association's bill (Tr 1/13:49).

Poxson could not recall any specific discussion about net worth other than that he had said to the General Counsel's Committee: "Nobody feels sorry for General Motors" (Tr 1/13:48, 66). Poxson testified that there was no discussion of the meaning of net worth or its application or whether net worth was indicative of financial condition (Tr 1/13:66).[3]

Poxson said that, as a member of the General Counsel's Committee, he was primarily concerned with representing the interests of Michigan Mutual (Tr 1/13:48, 67). Poxson was very concerned about limiting the economic impact of the legislation on Michigan Mutual, and thus wanted to make sure that the

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[3] Poxson recalled that the General Counsel's Committee considered and rejected utilizing "assets" as a standard (Tr 1/13:66). This does not establish any consideration of net worth. Poxson could not recall any discussion of net worth other than his comment about General Motors.

amount of the assessment was limited to 1% of premiums (Tr 1/13:49, 67).

The General Counsel's Committee's bill was introduced in the Michigan legislature as a substitute bill on May 2, 1969 (17 days after the original bill had been introduced). It was enacted on August 11, 1969. There was no testimony introduced concerning any legislative committee discussions or legislative debates regarding the net worth limitation other than Poxson's testimony, which related only to the General Counsel's Committee — a nonlegislative committee dominated by private interest.

Net worth is not defined in the Act; its commonly accepted definition is the balance sheet entry showing recorded assets in excess of recorded liabilities (Tr 1/11:13).

Borman's presented testimony that net worth is meaningless as an indicator of financial condition or ability to absorb loss. This evidence was uncontroverted. It was demonstrated by factual examples of broad application such as LIFO (last in, first out) vs. FIFO (first in, first out) inventory valuation, cash vs. accrual accounting methods, personal vs. business accounting and depreciation of real estate vs. appreciation of value. It was also demonstrated by more specific applications such as leveraged buyouts, stock repurchases, declaration of dividends and statutory vs. generally accepted accounting principles ("GAAP").

Thus, the net worth of a person or business may change radically based on factors entirely within their control, such as a change in accounting methods, a declaration of dividends, leveraged buyout, restructuring of capital and changes in tax reporting (Tr 1/11:16-17). These factors do not indicate whether the company has done better or worse in terms of its operations (Tr 1/11:17).

The same company may have differing net worths depending solely on the method of accounting (Tr 1/11:16). For example, valuing inventory under the LIFO method will render a different value than utilizing a FIFO method (Tr 1/11:16). A change in the method utilized for valuing inventory results in different net

worths. Indeed, Borman's general counsel testified that shortly before the trial, the company gave serious consideration to changing from the LIFO to the FIFO method of accounting for inventory. This change would have increased Borman's net worth from a negative $870,000 to a positive $15.8 million, but its financial condition would not have changed (Tr 1/9:71-72). Under its existing LIFO method, Borman's would have been covered under the Act as of the date of trial, but if Borman's had changed to FIFO it would not have been covered.

The Association's evidence was consistent with Borman's. Two of the Association's witnesses testified that insurance companies typically prepare two financial statements — one under statutory requirements and one under GAAP (Tr 1/17:115; Tr 1/18:23). The so-called net worth of the insurance company will vary "radically" depending on which method is utilized in preparing the financial statement (Tr 1/18:23).

There is no question that in many of these situations, where net worth differs, the entity's financial condition and its ability to absorb loss are the same regardless which number is utilized for net worth.

Borman's also introduced evidence comparing its net worth to that of Safeway Stores, Incorporated, one of the largest supermarket chains in the world (Tr 1/9:74). For the fiscal year ending December 18, 1985, Safeway had more than $4.8 *billion* of assets, more than $19.6 *billion* of sales and a net worth of more than $1.6 *billion*. One year later, Safeway's assets had increased to more than $7.4 *billion* and its sales to more than $20 *billion*, but its net worth had dropped to $2.9 *million* (a change of $1.6 *billion*). Another year later, Safeway's assets were in excess of $4.9 *billion* and its sales were $18 *billion*, but its net worth had dropped to negative $460,000. The decrease in Safeway's net worth was the result of a leveraged buyout and changes in accounting practices and not a change in business conditions (Tr 1/9:81-82). As a result of the leveraged buyout, Safeway would have been covered under the Act.

The evidence also established that the same assets and liabilities would result in differing net worths depending on the form of ownership. For example, a building owned by an entity is generally carried on its books at a depreciated value even if the building appreciates in value. Hence, the entity owning a building would normally experience a decrease in net worth over time even though the building's market value (and hence the entity's value) will often increase (Tr 1/11:21-26). The same building owned by an individual would probably be valued on the individual's financial statement at market value (Tr 1/18:22). *Thus, the same assets and liabilities would yield differing net worths depending on the form of ownership.* And, with respect to the entity, because the value of the asset as shown on the books is artificial, the net worth figure (recorded assets less recorded liabilities) is likewise artificial.

David Simmons, an accounting expert, testified *without contradiction*, that in determining whether to loan money to an individual or entity and in determining whether an individual or entity is able to withstand an unexpected loss, one must examine the individual or entity's entire financial condition and that net worth alone tells nothing.[4] Simmons explained that the age and type of receivables and inventory must be analyzed in determining financial condition, as well as contracts restricting available cash:

Q: Does networth mean the same thing to you as financial condition?

A. No.

Q: Can you tell me what factors go into determining the financial condition of an enterprise or business?

A: Uhmm, they're numerous. The financial condition of an organization has many factors which I can relate. First and foremost, probably, it would be easier to divide them

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[4] Simmons is a partner in what was Touche Ross and Company. He has insurance company clients as well as other types of business clients (Tr 1/11:10-11).

between general economic or management factors and those which are peculiar to the financial statements. In the case of the financial statements, the financial condition can only be assessed by understanding the financial statements and what each of the assets and liabilities and other obligations in the organization may be. For example, while we probably all well understand the terminology cash, there are many times when cash is restricted by loan agreement or debt agreement.

We must understand the nature of the assets in that many assets can have differing values and differing liquidity between organizations. For example, receivables from customers can be very current or they can be noncurrent, meaning that they may be in excess of one year due — in excess of one year beyond the balance sheet date.

Inventory. We mentioned LIFO versus FIFO and those are two accounting conventions which management can choose, but it's necessary to understand whether or not LIFO is being used in the preparation of financial statements or LIFO [sic], because they have — they have differing impacts on the value of the assets, as well as the operation of the organization . . .

(Tr. 1/11:17-18).

Simmons also explained that net worth includes all assets, whether tangible or intangible, and thus does not present a true picture of financial condition:

A. It's necessary to understand the differences between intangible assets and tangible assets. Tangible assets are generally viewed by outsiders as being something that someone at some point can get their hands on. So, therefore, they have more value to lenders and, therefore, can be used as collateral in loans. But on the other hand intangible assets, such as goodwill, copyrights, distributorship rights or anything that is given value, which is

allowed by generally accepted accounting principles, it is not generally viewed as being a very liquid asset. So the overall analysis of the assets is essential to determine the liquidity of those assets.

(Tr. 1/11:18-19).

Simmons further testified that the true nature of the liabilities and the footnotes on the financial statement must be examined:

Q. Does networth mean the same thing as liquidity?

A. [O]ne must understand liabilities and one must understand the other obligations of the organization. The liabilities can very often times put many limitations on the operation of an organization, such as the restriction of dividends, the requirement that certain financial ratios be maintained. If those financial ratios are not maintained it's quite possible the agreements can require — or can allow the lender to take action to — under the loan agreement to foreclose or to otherwise recover its moneys loaned to the company.

The financial statements will also contain footnotes, which very often provide a great deal of insight as to obligations of the organization to unions and to employees under pension plans. It may talk about particularly favorable or unfavorable contracts for the future. It may talk about backlogs, sales backlog, and otherwise provide the reader of the financial statements with more information about the ongoing operations of the organization and possibly the future operations of the organization.

On the other hand, one must also understand what industry the organization is in, what the trends are that affect that industry, and all of the other parts of our every day life that might affect that organization.

(Tr 1/11:19-20)

Simmons said that net worth is not related to financial condition, and that in assessing ability to absorb loss, one must look at financial condition:

Q. *Is networth determinative of financial condition then?*

A. *No.*

* * *

Q. *In making a determination as to the ability of a business or enterprise to absorb an uninsured casualty loss, what would you look to:*

A. *I would look to the overall financial condition.*

* * *

Q. Mr. Simmons, if I came to you and I indicated that there was a business or enterprise which had an $8,000,000 networth figure, and asked you whether or not that business or — and that's all I told you — and asked you whether or not that business or enterprise could absorb a 3 and a half million dollar casualty loss, based solely on that networth figure, could you tell me whether it could or could not?

A. I could not tell you.

Q. Why is that?

A. I don't have enough information to understand the financial condition of the organization.

Q. *Does the term networth in and of itself, in your opinion, is it in any way determinative of the ability of a business or enterprise to absorb an uninsured casualty loss?*

A. *No.*

(Tr 1/11:20, 25-26, emphasis added).

Lawrence Sullivan, an insurance expert, agreed that net worth standing alone is meaningless and that you must look at

financial condition to determine whether one is able to absorb a loss (Tr 1/11:92; Tr 1/12: 34-35).[5]

The Association's witnesses agreed that net worth alone does not tell you the individual or entity's financial condition. George Gottheimer, the Association's insurance expert, admitted that net worth may vary from day to day and that net worth does not give any information about liquidity or collectibility of assets (Tr 1/17:61).[6] Gottheimer said that as to insurance companies, net worth is significant only "in conjunction with other things on the balance sheet," and as to noninsurance enterprises he could only "*suspect*" its relationship to financial condition.[7] In response to the District Court's question of whether one needs to look at things other than net worth in assessing financial condition, Gottheimer did not answer the question, but said that net worth is easy to administer and that is why he believes the legislature adopted the provision (Tr 1/17:62).

Jean Carlson, Michigan's Deputy Commissioner of Insurance for Policy, testified that she could tell nothing about the financial condition of an insurance or other company knowing only its net worth (Tr 1/17:113-117). Carlson said that in assessing the financial condition of an insurer, one would look at reserves, type of insurance, loss development, liabilities, reinsurance (and type) and agents' balances (Tr 1/17:113-114).

The testimony of James Lundsted, the Association's controller, shows that the Association's own net worth is not related to its ability to absorb losses. He testified that the Association's 1988

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[5] Sullivan has been involved in the insurance industry for about 35 years. He has worked on behalf of insurers and insureds (Tr 1/11:71-76).

[6] "Dr." Gottheimer, who received his Bachelors and Ph D degrees from correspondence schools, has spent his entire career representing insurance companies (Tr 1/17:16-19, 21).

[7] Even as to insurance companies, Gottheimer gave conflicting testimony. In the Spring of 1986, Gottheimer told a House of Representatives Subcommittee that insurance carriers' financial statements are "filled with errors" and that "cash flow" should be used in assessing the financial condition of an insurance carrier (Tr 1/17:31-32).

balance sheet showed a $38 million deficit in the category including general liability, yet the Association was able to pay all claims presented in 1988 in that category and has always been able to pay all claims (Tr 1/17:149-151). Lundsted said:

> Q. So it is a correct statement when analyzing Exhibit 1 that, in trying to determine the ability of the association to absorb losses, i.e. pay outs in any particular year, you have to go beyond the bottom line figure that says member's equity or deficit and look at the reserves established, and numbers of years to be paid out, and anticipated assessments in those future years?
>
> A. That would all enter into it.

(Tr 1/17:151).

Julius Otten, *the Association's accountant*, agreed with Borman's position that net worth is dependent on the method of accounting utilized and that "net worth is not in and by itself indicative of the financial condition of a company or business" because, he stated, "there are other things to be considered" (Tr 1/18:30-31, 42, 49-50). Otten said that corporations list assets based on historical cost, which may have absolutely nothing to do with fair market value — there is a radical difference between a corporation and an individual as to net worth even if both have the same assets (Tr 1/18:22). Otten agreed that net worth is not indicative of financial condition — he would not make an investment decision knowing only the entity's net worth (Tr 1/18:42).

REASONS FOR GRANTING THE WRIT

A. THE SIXTH CIRCUIT OPINION IS CONTRARY TO ESTABLISHED PRECEDENT OF THIS COURT REQUIRING THAT THE DISTRICT COURT CONDUCT A TRIAL AND THAT THE DISTRICT COURT'S FINDINGS BE AFFIRMED UNLESS CLEARLY ERRONEOUS

In *Borden's Farm Products Co.* v. *Baldwin*, 293 U.S. 194, 210, 55 S.Ct. 187, 79 L.Ed. 281 (1934), this Court held that where, as here, the rational basis of legislation depends on facts "outside the sphere of judicial notice, these facts are properly the subject of evidence and of findings." Thus, in denying cross-motions for summary judgment, the District Court properly held that the question of rational basis required factual development.

Borden's involved an equal protection challenge to a New York minimum milk pricing statute that established a differential of 1¢ per quart in favor of milk dealers "not having a well-advertised name," i.e. "independents." The statutory provision at issue in *Borden's* "was added in the course of legislative consideration of proposed measures and at the insistence of dealers described as independents." 293 U.S. at 205, n.7. As in *Borden's*, in our case the provision in question was added to the bill, not by legislators, but at the insistence of interested parties, i.e. general counsel of major insurance companies — parties who had a direct financial interest in the legislation. In *Borden's*, the State asserted several so-called rational bases and invoked the presumption of constitutionality (blindly applied by the Sixth Circuit here). This Court rejected the State's arguments and declared:

> But that [presumption of constitutionality] is a presumption of fact, of the existence of factual conditions supporting the legislation. As such it is a rebuttable presumption. It is not a conclusive presumption, or a rule of law which makes legislative action invulnerable to constitutional assault. *Nor is such an immunity achieved by treating any fanciful conjecture as enough to repel attack.*

* * *

> [I]t is increasingly important that when it becomes necessary for the Court to deal with the facts relating to particular commercial or industrial conditions, they should be presented concretely with appropriate determinations upon evidence, so that conclusions shall not be reached without adequate factual support.

293 U.S. at 209, 210 (citations omitted, emphasis added).

In this case, the District Court properly concluded that a trial was necessary and then, based on the facts presented at the trial, held that the net worth classification "is arbitrary and is not a classification which is rationally related to the Michigan legislature's purpose of allocating loss to those best able to absorb loss." 717 F. Supp. at 479, Appendix at A-37.

The Circuit Court did not hold that the District Court erred in denying summary judgment or in conducting a trial. Nor did the court determine that any of the District Court's factual findings were clearly erroneous. Rather, the Circuit Court made its own findings that the *conclusions* of the Association witnesses were credible.

Borman's recognizes the principles of law cited by the Circuit Court, i.e. the presumption that legislation is constitutional and that legislation must be upheld "if any *state of facts* reasonably may be conceived to justify it." 925 F.2d at 162-163, Appendix at 4-5 (emphasis added). In this case, there was no evidence of any debate or consideration by the legislature or of any studies or facts presented to the legislature. In view of the lack of such evidence, it then became incumbent on the District Court to determine whether the legislature could have concluded that there was a rational basis. Based on the assumption that the legislature considered the facts presented at trial (we cannot assume that the legislature considered anything else), the District Court determined that the legislature could not have concluded that there was a rational basis to support the classification.

The Circuit Court committed error when it substituted its judgment for that of the trial court. Rule 52(a), Fed. R. Civ. P. mandates that the trial court's findings "shall not be set aside unless clearly erroneous." According to this Court, rule 52(a) applies to all types of cases, with the limited exception of First Amendment cases. *Anderson* v. *Bessemer City*, 470 U.S. 564, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985); *Pullman-Standard* v. *Swint*, 456 U.S. 273, 102 S.Ct. 1781, 72 L.Ed.2d 66 (1982); *Bose Corp.* v. *Consumers Union of the United States, Inc.*, 466 U.S. 485, 104 S.Ct. 1949, 80 L.Ed.2d 502 (1984).

Constitutional issues are not an exception —"an issue does not lose its factual character merely because its resolution is dispositive of the ultimate constitutional question." *Miller* v. *Fenton*, 474 U.S. 104, 113, 106 S.Ct. 445, 88 L.Ed.2d 405 (1985).

Recently, this Court again addressed the distinction between factual findings and legal conclusions and reiterated the "superiority of the district court's fact finding ability" and the mandated deference accorded to the district courts under rule 52(a). *Salve Regina College* v. *Russell*, 499 U.S. , 111 S.Ct. , 113 L.Ed.2d 190, 199 (1991).

There was no legitimate reason for the Sixth Circuit to ignore rule 52(a) in this case. The court gave no reason for not applying the rule and, despite the fact that the rule was cited in Borman's brief on appeal and in its petition for rehearing, the Circuit Court did not even cite the rule.

The Circuit Court was required under rule 52(a) to accept the factual findings of the District Court. However, the court fell into the trap (which the District Court avoided) of assuming that it knew the significance of net worth. The facts introduced at trial established (contrary to the appellate reaction) that net worth is meaningless, standing alone, as an indicator of financial condition or ability to absorb loss. Accepting these findings, as it must (unless clearly erroneous), the Circuit Court was required to affirm the District Court.

The Circuit Court ignored the seven days of testimony and substituted its opinion (apparently taking improper judicial notice) as to the relationship between net worth and the ability to absorb an uninsured loss. The testimony cited by the Sixth Circuit, on which it based its decision, consists of *conclusions* (not facts), which the District Court found were not supported by the *facts* developed at trial.

The Circuit Court cited George Gottheimer Jr.'s testimony that in his opinion the net worth limitation was intended to avoid affording "those individuals and corporations with large wealth, the same benefits as unsophisticated individuals with modest means, given the resources available." 925 F.2d at 163; Appendix at A-5. However, Gottheimer's opinion is merely another way of stating the purpose of the net worth provision, as articulated by the District Court — to allocate loss to those persons best able to absorb loss. Identification of the legislative purpose is separate from the questions of rational relationship and arbitrariness. Gottheimer's opinion does not even address the questions presented at trial of whether net worth is rationally related to the legislative purpose or whether the standard is arbitrary.

As to these questions, Gottheimer testified he had no knowledge of the relationship between the net worth of noninsurance companies and financial condition (*i.e.* ability to absorb loss). And, as to insurance companies (about which Gottheimer claimed to be an expert), Gottheimer conceded that net worth standing alone is meaningless — it is significant only "in conjunction with other things on the balance sheet." Hence, Gottheimer's testimony fully supports petitioner's position that net worth is not rationally related to the legislative purpose.

The Sixth Circuit also cited Elijah Poxson's personal belief that a person with a net worth of $1 million was a person with substantial wealth. Poxson was an interested party and not an expert witness. His "personal belief" was not based on facts and was negated, as the District Court found, by uncontradicted testimony that net worth standing alone is meaningless and is not indicative of financial condition.

The Sixth Circuit also relied on the testimony of Julius Otten, the Association's accountant, that in his opinion there is "a rational relationship between net worth and the capacity to absorb loss" because he "think[s] it's commonly perceived to be the cushion that either an insurance or commercial company can fall back on." 925 F.2d at 163, Appendix at A-6.

However, Otten's opinion elicited during direct examination was contradicted by his testimony on cross examination, where *he conceded that net worth standing alone is meaningless:*

> Q. If I came to you, Mr. Otten, and said I have a company that has a networth of $10,000,000, would you invest in that company based solely on that networth figure without investigating further and looking at liquidity and cash flow?
>
> A. I think there would be a lot of information that I'd be interested in reviewing before making an investment decision, and certainly liquidity and cash flow might be among them.
>
> Q. *And, is the reason that you would look at all that information, that networth is not in and of its — by itself indicative of the financial condition of a company or business?*
>
> A. *Uhmm, there are other things to be considered, yes, could be considered.*

See also 717 F. Supp. at 474-475, Appendix at A-29 through A-30, describing an example about which Otten testified showing net worth was not related to financial condition.

As the District Court found, other Association witnesses (James Lundsted, the Association's controller, and Jean Carlson, an employee of the Insurance Bureau) admitted that net worth does not tell you about financial condition. 717 F. Supp. at 476, Appendix at A-32, A-33.

The Circuit Court did not point to any facts in the record supporting its conclusion that net worth is related to the ability to absorb an uninsured loss. Rather, the court in effect held that the personal beliefs and conclusions of the Association witnesses created an irrebuttable presumption of constitutionality. This holding runs directly contrary to the dictates of *Borden's*, wherein this Court declared that such beliefs are rebuttable:

> It is not a conclusive presumption, or a rule of law which makes legislative action invulnerable to constitutional assault. Nor is such an immunity achieved by treating any fanciful conjecture as enough to repel attack.

293 U.S. at 209.

The District Court was required under Borden's to conduct a trial and make findings to insure that "conclusions shall not be reached without adequate factual support." 293 U.S. at 210. The District Court followed the *Borden's* mandate — it considered the conclusions of the experts (i.e. that net worth is or is not rationally related to the ability to absorb loss) and found that the Association's conclusions were not supported by the facts presented at trial and that Borman's conclusions were supported by the facts presented at trial.

The Circuit Court's opinion renders *Borden's* meaningless in cases involving not only guaranty fund legislation, but in all cases where factual development is necessary to determine constitutional questions. In violation of *Borden's*, the court relied on conclusions which were not supported by the facts and rejected out-of-hand and without reason the District Court's findings.

The Circuit Court also violated rule 52(a). It ignored the District Court's factual findings. Under the Sixth Circuit's analysis, circuit courts will review trials *de novo* and not give the required deference to district courts for their factual findings. And, under the Circuit Court opinion, a witness could contradict himself and give conflicting opinions, but so long as one opinion is

in favor of constitutionality, an irrebuttable presumption is created, making cross-examination irrelevant and pointless.[8]

This Court should grant review to correct the Circuit Court's erroneous decision and to apply the appropriate standard of review of *factual findings* issued after a trial involving a constitutional question.

B. THE SIXTH CIRCUIT OPINION THAT THE NET WORTH PROVISION IS CONSTITUTIONAL BECAUSE IT IS EASY TO ADMINISTER IS CONTRARY TO ESTABLISHED PRECEDENT OF THIS COURT

The Sixth Circuit based its holding, in part, on testimony that net worth is easily determined and thus easy to administer, citing *Weinberger* v. *Saefi*, 422 U.S. 749, 95 S.Ct. 2457, 45 L.Ed.2d 522 (1975). *Weinberger* involved a constitutional challenge to a prophylactic statutory provision because it was imprecise.

This case does not involve imprecision or a provision that is over or under inclusive or a partial or step-by-step plan to eradicate an evil.[9] Rather, it involves, as the District Court found, an *arbitrary* classification which has no relationship to the statutory purpose.

---

[8] The Sixth Circuit ruled that because the District Court commented that the testimony was "conflicting," it was compelled to find in favor of the Association. 925 F.2d at 163, Appendix at A-5. The court misread the District Court's opinion. The "conflict" referred to by the District Court was not as to the facts, but rather as to the *conclusions* of the witnesses. Under *Borden's*, it was the District Court's duty to determine whether these conflicting conclusions were supported by the facts. The District Court found that the opinions of the Association's witnesses were not supported by the facts.

[9] Borman's proved that the net worth classification is arbitrary and irrational. While the proofs consisted in part of examples, that does not mean that Borman's asserted that the provision is under or over inclusive or imprecise. The examples are (as the Association witnesses conceded) typical. The Association presented no factual evidence that the classification is rational. More importantly, the evidence *from both parties* established that net worth alone is meaningless and not at all indicative of financial condition. Hence, the classification is arbitrary.

The District Court was required to examine the asserted bases for the legislation and determine whether they are "rationally related to a legitimate governmental purpose." *City of Cleburne* v *Cleburne Living Center*, 473 U.S. 432, 446, 105 S.Ct. 3249, 87 L.Ed.2d 313 (1985). "The state may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational." *Id.* And where, as here, the classification goes beyond "imprecision" to lack of rationality, it is invalid. *United States Dep't. of Agriculture* v. *Moreno*, 413 U.S. 528, 538, 93 S.Ct. 2821, 37 L.Ed.2d 782 (1973).

This Court has not held (as the Sixth Circuit characterized) that ease of administration is itself a rational basis. To the contrary, this Court has expressly held that arbitrary classifications cannot be upheld merely because they are easy to administer. *City of Cleburne* v. *Cleburne Living Center, supra*; *United States Dep't. of Agriculture* v. *Murry*, 413 U.S. 508, 513, 93 S.Ct. 2832, 37 L.Ed.2d 767 (1973) ("[T]he Constitution recognizes higher values than speed and efficiency.").

This Court should grant review to correct the erroneous opinion.

C. THIS COURT SHOULD GRANT THE PETITION BECAUSE THIS CASE HAS NATIONAL SIGNIFICANCE

At the time Borman's filed its complaint, 52 jurisdictions had guaranty fund legislation (the 50 states, Puerto Rico and the Virgin Islands). At that time, only two of these 52 jurisdictions had net worth limitations (Michigan and Georgia). Mich. Comp. Laws §500.7925(3); Ga. Code Ann. § 33-36-3(2)(F). The National Association of Insurance Commissioners ("NAIC") had rejected a net worth limitation in its model act (Tr 1/13:58-59, 67); however, in 1985, it amended the model act to include a $50 million net worth limitation. NAIC Model Act, §11(2).[10] Cur-

[10] The NAIC records show that a question was raised as to the constitutionality of a net worth provision.

rently, at least 12 jurisdictions have net worth limitations and others have or are considering such provisions in view of the Circuit Court's opinion in this case.[11]

The Guaranty Associations of seven states filed an amicus curiae brief on behalf of the respondent in the court below. The Michigan Municipal League and the Risk and Insurance Management Society filed amicus curiae briefs on behalf of Borman's.

The Michigan Municipal League is a non-profit corporation, whose membership consists of 500 Michigan cities and villages. The Michigan Municipal League pointed out that Michigan's net worth provision has been applied to governmental bodies, agencies and boards, which are non-profit making institutions and do not follow accounting practices similar to those of business entities or individuals.

The lower court opinions have been discussed in many insurance journals throughout the country. The question of constitutionality of the net worth statutory provision here at issue (and others similar to it) is one of first impression. Thus, the Sixth Circuit decision has nationwide impact on guaranty fund legislation.

In addition, the Circuit Court opinion governs not only the constitutionality of the net worth provision at issue, and others similar to it, but also establishes a standard of review contrary to that mandated by this Court where the District Court conducts a trial to resolve factual issues in a constitutional context.

---

[11] In addition to Michigan and Georgia, the following states have recently enacted net worth provisions in their guaranty fund legislation: Colorado (Colo. Rev. Stat. §10-4-504); Connecticut (Conn. Gen. Stat. §38a-844(4)(b)); Hawaii (Haw. Rev. Stat. §431:16-111); Illinois (Ill. Rev. Stat. §2.73 §1065.84-3(b)(iv)); Indiana (Ind. Code Ann. §27-6-8-4(4)(5)); Missouri (Mo. Rev. Stat. §375.722(2)(2); Oklahoma (Okla. Stat. Ann. Title 36 §2010(B)(1)); Rhode Island (R.I. Gen. Laws §27-34-11(2)(a)); Virginia (Va. Code Ann. §38.2-1609(2)(a)); Wisconsin (Wis. Stat. §646.31(12)); Utah (Utah Code Ann. §31A-28-207(3)(b)(i)). There is a bill now pending in the Delaware legislature to add a net worth provision to its guaranty fund act (1991 S.B. 140).

CONCLUSION

For these reasons, this Court should grant the petition for a writ of certiorari.

BARRIS, SOTT, DENN & DRIKER

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DATED: June 21, 1991

Opinion

RECOMMENDED FOR FULL TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 24

No. 89-2056

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

BORMAN'S, INC.
Plaintiff-Appellee,

v.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION
Defendant-Appellant.

ON APPEAL from the United States District Court for the Eastern District of Michigan

Decided and Filed February 7, 1991

Before: JONES and BOGGS, Circuit Judges; and GIBBONS, District Judge.*

JONES, Circuit Judge. This appeal presents the question of whether the district court erred in finding that Mich. Comp. Laws § 500.7925(3), which excludes from coverage certain insureds whose net worth exceeds a statutorily-calculated maximum under the Michigan Property & Casualty Guaranty Act, is not rationally

*Honorable Julia S. Gibbons, United States District Court for the Western District of Tennessee, sitting by designation.

related to a legitimate governmental purpose in violation of the equal protection clause of the United States Constitution and the Michigan Constitution. As we find that the district court exceeded its scope of review in assessing the constitutionality of § 500.7925(3), we reverse.

I.

Defendant-appellant Michigan Property & Casualty Guaranty Association ("the Association") is a group of insurers created under the Michigan Property & Casualty Guaranty Association Act (the "Act"), Mich. Comp. Laws § 500.7901 *et seq.* Membership in the Association is a prerequisite to transacting insurance business in the state of Michigan for all but a few specifically excluded insurers. Association members pay statutorily set assessments which are placed into a common fund that is used to pay certain "covered claims" of insolvent property-casualty insurers. Section 500.7925 lists the categories of "covered claims", and § 500.7925(3) excludes from the definition of covered claims, "obligations to . . . a person who has a net worth greater than 1/10 of 1% of the aggregate premiums written by member insurers in this state in the preceding calendar year." Although the Act does not define the term "net worth", the parties are in agreement that the general method for calculation of net worth is the difference between a business's total assets and its total liabilities.

On January 9, 1986, the action giving rise to this appeal was brought by Borman's Inc. ("Borman's"). Borman's is a Delaware corporation with its primary place of business in Michigan. Among its business concerns, Borman's owns the Farmer Jack supermarket chain, which consists of some eighty stores in Michigan. In the early 1980's a tort judgment was returned against Borman's for $1.15 million for injuries to a shopper in a Farmer Jack supermarket. $950,000 of that judgment was to be covered by Borman's insurance carrier Ideal Mutual

Insurance Company ("Ideal"). However, Ideal was declared insolvent by a New York court and Borman's was required to pay the judgment. Since Ideal was a member of the Association, Borman's filed a claim against the Association for the $950,000 it should have received from Ideal. The Association rejected Borman's claim against the Association's insolvency fund because Borman's net worth exceeded the statutory limit under the formula codified in § 500.7925(3).

Borman's brought this action in the U.S. District Court for the Eastern District of Michigan seeking declaratory and injunctive relief and challenging the constitutionality of § 500.7925(3) under the equal protection clause and article 1, section 2 of the Michigan Constitution. The district court denied cross-motions for summary judgment and a seven-day trial was held in January, 1989. The issue presented at trial was extremely narrow. The parties agreed on the method of calculation of net worth and that the purpose of the net worth calculation was to ensure that the Association's limited funds go to those insureds who are least able to absorb an unexpected loss due to the insolvency of an insurer. Thus, the sole issue for trial was whether use of a company's net worth to determine that company's ability to absorb loss was rational. Despite what the district court characterized as "conflicting testimony," J. App. at 135, it determined that net worth was not rationally related to a company's ability to absorb loss and therefore § 500.7925(3)'s exclusion of certain insureds from coverage of the Association's insolvency fund violated the equal protection clause.[1] This timely appeal followed.

---

[1]The district court found that analysis of this case under the equal protection clause of the fourteenth amendment and under article 1, section 2 of the Michigan Constitution are essentially identical. *See Manistee Bank and Trust Co. v. McGowan*, 394 Mich. 655, 232 N.W.2d 636 (1975). Therefore, as the district court did, we will confine our analysis to the rational basis test under the United States Constitution, and our conclusions will apply with equal force to Borman's claims under the Michigan Constitution.

II.

The burden upon a party seeking to overturn a legislative enactment for irrationally discriminating between groups under the equal protection clause is an extremely heavy one. When the legislation is economic or social in nature, as in this case, and neither a fundamental right nor a suspect class is involved, the level of scrutiny required is rational basis review.

> Under the rational basis test, which is applicable to economic and social legislation not involving "suspect classes" or impinging upon fundamental rights, "[a] statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it."

Baker v. Vanderbilt Univ., 616 F. Supp. 330, 331 (M.D. Tenn. 1985) (quoting *McGowan v. Maryland*, 366 U.S. 420, 426 (1961)). Thus, the Constitution affords a great deal of deference to state legislatures in creating statutory classifications for legitimate social or economic purposes.

> [T]he fourteenth amendment permits the State a wide scope of discretion in enacting laws which affect some groups of citizens differently than others. The constitutional safeguard is offended only if the classification rests on grounds wholly irrelevant to the achievement of the State's objective. State legislatures are presumed to have acted within their constitutional power despite the fact that, in practice, their laws result in some inequality.

Id. at 425-26. Further,

> States are not required to convince the courts of the correctness of their legislative judgments. Rather, "those challenging the legislative judgment must convince the court that the legislative facts on

> which the classification is apparently based could not reasonably be conceived to be true by the governmental decisionmaker." *Vance v. Bradley*, 440 U.S. [93,] 111 [(1979)]. . . .
>
> Although parties challenging legislation under the Equal Protection Clause may introduce evidence supporting their claim that it is irrational . . . , they cannot prevail so long as "it is evident from all the considerations presented to [the legislature], and those of which we may take judicial notice, that the question is at least debatable." [*United States v. Carolene Products Co.*, 304 U.S. 144, 153-54 (1938)].

Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 464 (1981).

Against this background, we must decide whether the Michigan legislature's determination that net worth was an appropriate means of predicting the ability of a company to absorb unexpected loss was so irrational that no state of facts "reasonably may be conceived to justify it." We find that within this extremely narrow scope of review, the Michigan legislature's reliance on net worth in § 500.7925(3) passes constitutional muster.

As the district court readily recognized, the testimony presented at trial was conflicting as to whether net worth was an indicator of a company's ability to absorb loss. Dr. George Gottheimer, Jr., an insurance industry expert, testified that the net worth provision was intended to avoid affording "those individuals and corporations with large wealth the same benefits [under the Association's insolvency fund] as unsophisticated individuals with modest means." J. App. at 643. Elijah Poxson, who was a member of the General Counsel's Committee of the Act, explained the inclusion of the net worth provision as follows:

> I believed that anyone, any person or corporation which had a net worth of a million dollars, in other words the difference between assets minus liabilities, was a person of substantial wealth and, therefore, would be able to bear a reasonably large unexpected loss without too much difficulty, even if they were uninsured.

Id. at 628-29. From this testimony, it would seem that the Michigan legislature might have been relying on net worth as an indicator of wealth, and thus as a stand-in for ability to absorb loss. Julius Otten, an accountant with substantial experience in insurance-related accounting issues, testified that net worth is "commonly perceived to be the cushion that either an insurance or commercial company can fall back on." *Id.* at 689. Otten characterized net worth as "an imperfect measure in that at times there can be real or perceived inequalities" but emphasized that "it certainly is an indicator of the capacity to absorb loss." *Id.* at 690. We agree with Otten's characterization of the value of net worth in making assessments of ability to absorb loss.

Though Borman's put on testimony which suggested that net worth was an unreliable and imperfect measure of ability to absorb loss, the test for constitutional purposes is not whether the legislative scheme is imperfect, but whether it is wholly irrational. *Pennell v. City of San Jose*, 485 U.S. 1, 13-14 (1988).

> In the area of economics and social welfare, a State does not violate the Equal Protection Clause merely because the classifications made by its laws are imperfect. If the classification has some "reasonable basis," it does not offend the Constitution simply because the classification "is not made with mathematical nicety or because in practice it results in some inequality." "The problems of government are practical ones and may justify, if they do not require, rough

accommodations -- illogical it may be, and unscientific."

Dandridge v. Williams, 397 U.S. 471, 485 (1970) (citations omitted). While the Association did not by any means prove that net worth was the best mechanism for determining ability to absorb loss, it did put on sufficient evidence to suggest that factual circumstances were conceivable which could justify the legislature's use of net worth as a proxy for a more complex calculation. Further, the Association put on evidence to suggest that the net worth standard was much easier to administer than more complex standards. While ease-of-administration, on its own, is not sufficient to justify an otherwise irrational legislative enactment, *United States Dep't of Agriculture v. Murry*, 413 U.S. 508, 513 (1973), it is beyond dispute that the legislature may consider the administrative difficulties of individual eligibility determinations in making "a substantive policy determination that limited resources would not be well spent in making individual determinations." *Weinberger v. Salfi*, 422 U.S. 749, 784 (1975). In enacting § 500.7925(3), the legislature conceivably may have concluded that the ease of administration and the preservation of limited fund resources for legitimate claimants justified the adoption of the rough net worth standard rather than a more precise mechanism of individual determination. Even when the wisdom of judgment of the State legislature is debatable, a federal court is not free to set aside the legislature's judgment to substitute its own. *Kelly v. Metropolitan Bd. of Educ. of Nashville and Davidson Cty. Tenn.*, 836 F.2d 986, 996 (6th Cir. 1987), *cert. denied*, 487 U.S. 1206 (1988).

III.

While the district court may well have been correct in its determination that net worth is not the best way to determine an insured's ability to absorb loss, the district court erred in determining that Mich. Comp. Laws § 500.7925(3) was not rationally related to a legitimate state purpose under current constitutional standards. Therefore, we **REVERSE.**

Judgment
(Filed: February 7, 1991)

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No: 89-2056

BORMAN'S INC.
Plaintiff-Appellee

v.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION
Defendant-Appellant

Before: **Jones,** and **Boggs,** *Circuit Judges;*
Gibbons, *District Judge*

JUDGMENT
(Filed: February 7, 1991)

ON APPEAL from the United States District Court for the Eastern District of Michigan at Detroit.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is ordered that the judgment of the district court is reversed.

ENTERED BY ORDER OF THE COURT

(s) Leonard Green, *Clerk*

Issued as Mandate: April 3, 1991

COSTS: NONE

Filing Fee ..... $
Printing ..... $
Total ..... $

A True Copy.

Attest:

(s) Sharon R. Tallaucf
Deputy Clerk

Order
Filed: March 25, 1991

No. 89-2056

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

BORMAN'S INC.,
Plaintiff-Appellee,

v.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION,
Defendant-Appellant

BEFORE: JONES and BOGGS, *Circuit Judges;* and GIBBONS*, *United States District Judge.*

ORDER
(Filed: March 25, 1991)

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE COURT

(s) Leonard Green, *Clerk*

---

* Hon. Julia S. Gibbons sitting by designation from the Western District of Tennessee

Order
Filed: August 29, 1989

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

BORMAN'S, INC., a Delaware corporation,
Plaintiff,

vs.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION, a Michigan association,
Defendant.

Civil Action No. 86-CV-70122-DT

HON. BARBARA K. HACKETT

_____/

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_____/

ORDER AMENDING ORDER AMENDING FINDINGS

At a session of court, held in the U.S. Courthouse, Detroit, Wayne County, Michigan on Aug. 29, 1989.

PRESENT: HON. BARBARA K. HACKETT
U.S. District Court Judge

On June 30, 1989, the Court issued its opinion and judgment finding that Mich. Comp. Laws §500.7925(3) violates plaintiff's right to equal protection under the law as provided by both the United States and Michigan Constitutions. On July 31, 1989, the Court issued the following two orders amending its findings, opinion and judgment:

Order
Filed: August 29, 1989

a) Order Granting Defendant's Motion to Amend Findings; and

b) Order Amending Judgment and Opinion

Borman's has filed a motion to amend the Order Granting Defendant's Motion to Amend Findings for the reason that the order forecloses Borman's from asserting claims that were timely filed with the Association, but that were not resolved by June 30, 1988.

The Court has carefully considered Borman's motion and grants the motion. Accordingly, the paragraph of the July 31, 1989 Order Granting Defendant's Motion to Amend Findings immediately preceding "IT IS SO ORDERED" is vacated and the following is inserted therein:

> The Court has carefully considered the Association's motion to amend findings, and Borman's response thereto, and grants the Association's motion. Accordingly, the Court's June 30, 1989 opinion is amended to provide that, except for the amounts that the court has ordered defendant to pay to plaintiff and except for all claims filed by plaintiff with defendant on or before February 7, 1986 under the Ideal policies, the opinion applies prospectively only-to claims filed with the Association arising under insurance policies with insurance carriers that become insolvent after the date of the court's June 30, 1989, opinion and judgment. Other than the claims listed in plaintiff's exhibit 11, this Court is not adjudicating the timeliness of any claim filed by plaintiff.

(s) HON. BARBARA K. HACKETT

A TRUE COPY
CLERK, U.S. DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
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DEPUTY CLERK

Order
Filed: July 31, 1989

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

BORMAN'S INC., a Delaware corporation,
Plaintiff,

vs.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION, a Michigan association,
Defendant.

Case No. 86-CV-70122-DT

HON. BARBARA K. HACKETT

_____/

ORDER GRANTING DEFENDANT'S MOTION TO AMEND FINDINGS

On June 30, 1989, the court issued its opinion and judgment finding that *Mich. Comp. Laws Ann.* § 500.7925(3) violates plaintiff's right to equal protection under the law as provided by both the United States and Michigan Constitutions. In so doing the court held that, but for certain damages awarded to plaintiff, the court's ruling would apply prospectively. Defendant now seeks, pursuant to Fed.R.Civ.P.52(b), to have the June 30, 1989, opinion amended to clarify the court's ruling as it relates to the issue of nonretroactivity. Defendant requests that, except for the amounts that the court has ordered defendant to pay to plaintiff, the opinion apply prospectively to claims against insurers that become insolvent after the date of the court's June 30, 1989, opinion and judgment. Borman's has responded by stating, in effect, that it objects to the Association's request to the extent that it may impact on Borman's.

The court has carefully considered the Association's motion to amend findings, and Borman's response thereto, and grants the Association's motion. Accordingly, the court's June 30, 1989, opinion is amended to provide that, except for the amounts that the court has ordered defendant to pay to plaintiff, the opinion, applies prospectively only-to claims filed with the Association arising under insurance policies with insurance carriers that become insolvent after the date of the court's June 30, 1989, opinion and judgment.

Order
Filed: July 31, 1989

IT IS SO ORDERED.

(s) BARBARA K. HACKETT
United States District Judge

Dated: July 31, 1989

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MICHIGAN

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Order
Filed: July 31, 1989

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

BORMAN'S, INC.,
a Delaware corporation,
Plaintiff,

vs.

Civil Action No.
86-CV-70122-DT

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION, a Michigan association,
Defendant.

HON. BARBARA K. HACKETT

_____/

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_____/

ORDER AMENDING JUDGMENT AND OPINION

At a session of court, held in the U.S. Courthouse, Detroit, Wayne County, Michigan on July 31, 1989.

PRESENT: HON. BARBARA K. HACKETT
U.S. District Court Judge

On June 30, 1989, this Court issued a Judgment in favor of plaintiff, Borman's Inc., for the reasons stated in the Opinion of the same date.

Order
Filed: July 31, 1989

Plaintiff filed a timely motion to amend judgment under FRCP 52(b). Defendant has not filed a response.

WHEREFORE, IT IS ORDERED:

1. Plaintiff's motion to amend judgment is granted.

2. This Court's Judgment and Opinion of June 30, 1989, are hereby amended to include the following:

> Defendant is ordered to pay and discharge all claims set forth in Plaintiffs' Trial Exhibit No. 11* without regard to or consideration of the net worth exclusion and without regard to any delay caused by defendant's refusal to accept claims filed by plaintiff.

3. In all other respects the Judgment and Opinion shall remain in full force and effect.

(s) BARBARA K. HACKETT
United States District Judge

Order
Filed: July 31, 1989

BORMAN'S, INC.
AMOUNTS DUE FROM IDEAL MUTUAL
AS OF JUNE 30, 1988

Claimant	Amount Paid	Date
Hortense Session	$ 50,000	March 26, 1985
Norris Frye	950,000	June 3, 1985
Zakrzewski	726	June 18, 1985
Zakrewski	500	June 18, 1985
Zakrewski	30,000	July 17, 1985
Broadnax	12,000	September 13, 1985
Broadnax	73,000	September 13, 1985
Pentrack	20,000	October 16, 1985
Wengrow	65,000	June 14, 1986
Pollum	2,000	January 13, 1987
Clark	32,942	July 9, 1987
Thomas	15,000	September 8, 1987
Kilp	15,000	December 15, 1987
Total Claims Paid	$1,266,168*	

* Excludes $50,000 self-insured retention and Ideal's share of defense costs.

Judgment

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN

BORMAN'S, INC.

v.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION

JUDGMENT IN A CIVIL CASE

CASE NUMBER: 86-CV-70122-DT

☐ **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that judgment enter for plaintiff in this case for the reasons stated in the opinion filed this date.

Date June 30, 1989

(s) DAVID R. SHERWOOD
Clerk

(s) Lisa Teets
(By) Deputy Clerk

A TRUE COPY
CLERK, U.S. DISTRICT COURT
EASTERN DISTRICT OF
MICHIGAN

(s) Lisa Teets
DEPUTY CLERK

Opinion

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

BORMAN'S, INC.,
Plaintiff,

vs. CASE NO. 86-CV-70122-DT

MICHIGAN PROPERTY AND CASUALTY GUARANTY ASSOCIATION, HON. BARBARA K. HACKETT
Defendant.

OPINION

Plaintiff Borman's, Inc. (Borman's), is a Delaware corporation authorized to do business in the State of Michigan. Its principal place of business is located in the City of Detroit. Borman's is the owner and operator of the Farmer Jack Supermarkets chain. At the time the complaint was filed, there were more than 80 Farmer Jack stores located in the State of Michigan. Borman's also owns and operates certain subsidiaries and divisions involved in the manufacture and distribution of food products.

Defendant Michigan Property and Casualty Guaranty Association (Association) is a Michigan association created under the Michigan Property & Casualty Association Act (Act), MCL 500.7901, *et seq.* With limited exceptions, all insurers authorized to transact insurance in Michigan must be members of the Association. When a member insurer becomes insolvent, the Association steps into the insurer's shoes. The Association has the right to appear and defend claims, and the obligation to pay and discharge "covered claims." MCL 500.7931.

It is plaintiff's position that section 500.7925(3) of the Act, which denies reimbursement of claims filed by "... a person who has a net worth greater than 1/10 of 1% of the aggregate premiums written by member insurers in this state in the preceding calendar year," denies plaintiff its right to equal protection under the law as guaranteed by the fourteenth amendment to the United States Constitution and by article I, section 2, of the Michigan Constitution. For the reasons set forth below, the court agrees with plaintiff's position and finds that the means chosen to identify claimants entitled to reimbursement under the Act, that

is, solely on the criterion of the claimant's net worth, is not rationally related to the legislative purpose of allocating loss to those best able to absorb loss. Therefore, the court determines that section 500.7925(3) of the Act violates plaintiff's right to equal protection under the law as guaranteed by both the United States and Michigan Constitutions.[1]

The Act

The Act provides:

> To implement this chapter, there shall be maintained within this state, by all insurers authorized to transact in this state insurance other than life or disability insurance ... an association of those insurers to be known as the property and casualty guaranty association, hereafter referred to as the "association". Each insurer shall be a member of the association, as a condition of its authority to continue to transact insurance in this state.

MCL 500.7911(1). The Association is managed by a board of governors comprised of five member insurers and two persons from the general public. MCL 500.7912.

The Association's costs for administration, claims, and defense are paid for by an assessment levied on the member insurers:

> To the extent necessary to secure funds for the association for payment of covered claims and for payment of reasonable costs of administering the association, including the cost of indemnifying members of the board of governors, other member insurers, officers, employees, and other persons acting on behalf of the association to the extent permitted by law and the plan of the operation, the association shall levy assessments upon all member insurers. The association shall allocate its claim payments and costs to the following 5 categories:
>
> (a) Worker's compensation insurance.

---

[1] Plaintiff also takes the position that application of the formula contained in section 500.7925(3) of the Act constitutes a denial of due process under the United States and Michigan Constitutions. Having found that plaintiff's right to equal protection under the laws has been violated by section 500.7925(3), the court finds it unnecessary to address plaintiff's due process argument.

(b) Automobile insurance.

(c) Title insurance.

(d) Fire, allied lines, farm owner's multiple peril, homeowner's multiple peril, inland marine, earthquake and credit insurance.

(e) All other kinds of insurance except life and disability insurance.

MCL 500.7941(1). Under the Act, assessments are charged per category and may only be used to pay for claims and costs associated with that particular category:

> Separate assessments shall be made for each category prescribed in subsection (1) [MCL 500.7941(1)]. The assessments for each category shall be used to pay the claim payments and costs allocated to that category. The assessment for each category shall be in proportion to the net direct premiums written, after deducting dividends paid or credited to policy holders, by each member insurer in this state for kinds of insurance included within each category, as reported in the most recent annual statement available at the time of assessment. The rate of assessment shall be a uniform percentage of the premiums for all member insurers. The assessments shall be remitted to and administered by the association in accordance with the plan of operation. Each member insurer assessed shall have not less than 30 days' advance written notice of the date the assessment is due and payable.

MCL 500.7941(2). As provided by the Act, member insurers may pass the cost of such assessments to their insureds as part of the premiums, and thus *the funds needed by the Association to pay claims are paid by the insureds to the extent the assessments are included in the rates.* Insureds who pay more premiums thus pay more assessment dollars. MCL 500.7941(4).

The Act provides that in order for a claim to be a "covered claim," it must arise out of a policy of an insolvent member insurer, and must be issued to a Michigan resident or payable to a Michigan resident:

> "Covered claims" means obligations of an insolvent insurer which meet all of the following requirements:

> (a) Arise out of the insurance policy contracts of the insolvent insurer issued to residents of this state or are payable to residents of this state on behalf of insureds of the insolvent insurer.
>
> (b) Were unpaid by the insolvent insurer.
>
> (c) Are presented as a claim to the receiver in this state or the association on or before the last date fixed for the filing of claims in the domiciliary delinquency proceedings.
>
> (d) Were incurred or existed before, at the time of, or within 30 days after the date the receiver was appointed.
>
> (e) Arise out of policy contracts of the insolvent insurer issued for all kinds of insurance except life and disability insurance.
>
> (f) Arise out of insurance policy contracts issued on or before the last date on which the insolvent insurer was a member insurer.

MCL 500.7925(1). The amount of a covered claim is limited to the amount of coverage afforded under the policy and the maximum claim limit described in the Act. MCL 500.7925(4)(5).

Under the Act, persons and entities who have a net worth in excess of a statutory formula cannot recover from the fund:

> Covered claims shall not include obligations to an insurer, insurance pool, underwriting association, or to a person who as *a net worth greater than 1/10 of 1% of the aggregate premiums written by member insurers* in this state in the preceding calendar year.

MCL 500.7925(3) (emphasis added). Net worth is not defined in the Act. Borman's has challenged the constitutionality of section 500.7925(3). Borman's asserts that because there is no rational relationship between an insured's net worth and the insured's ability to absorb loss, Section 500.7925(3) violates the equal protection clauses of the United States and Michigan Constitutions.

Opinion

Background

At trial, the Association offered the testimony of Elijah Poxson. Poxson was employed by Michigan Mutual Insurance Company (Michigan Mutual) from 1941 until 1977, at which time he took an early retirement. In 1969, he was General Counsel for Michigan Mutual and subsequently became Vice-President and Secretary. From 1974-1977, Poxson was the President of Michigan Mutual. During much of his employment with Michigan Mutual, Poxson participated in the American Mutual Insurance Alliance, a national trade association for insurance carriers (Trade Association). The Trade Association monitors legislation, attempts to affect the course of legislation, and participates as amicus curiae in litigation affecting the insurance industry.

Poxson testified that in the late 1960's the question of guaranty association legislation was discussed during Trade Association meetings. According to Poxson, certain federal legislation had been proposed which the insurance industry did not want enacted. In an effort to thwart such federal legislation, the Trade Association formed a sub-committee sometime in 1968, of which Poxson was a member, to draft a proposed model bill for state regulated post-assessment guaranty associations. The sub-committee drafted a proposed bill which was approved by the Trade Association. The proposed Trade Association model bill provided for a net worth limitation of $1 million, and provided for a maximum assessment on member insureds of 1% of net direct annual premiums written. The Trade Association bill was presented to and rejected by the National Association of Insurance Commissioners (NAIC). The model act ultimately accepted by the NAIC contained no net worth limitation, and contained a maximum assessment of 2% of net direct annual premiums written.

At the State level, on April 15, 1969, House Bill No. 3699 was introduced in the Michigan legislature. This was the original version of the bill that eventually became the Michigan Property & Casualty Association Act. House Bill No. 3699 did not contain a net worth limitation. Between April of 1969 (original bill) and May of 1969 (when a substitute bill was introduced), Poxson was asked to sit on a General Counsels' Committee to review the pending bill. The committee consisted of approximately five

general counsels of major insurance companies and an actuary from the Michigan Insurance Bureau. Poxson reviewed House Bill No. 3699 but, according to his testimony, did not find it to his liking. He then obtained a copy of the model bill that the Trade Association sub-committee had drafted, and gave it to the actuary sitting on the General Counsel's Committee to be used as a substitute bill for presentation to the Michigan legislature. The Trade Association model bill was discussed at the meetings of the General Counsels' Committee. Poxson could not recall any specific committee discussion of the net worth provision, but he did state that the committee members agreed that a net worth limitation should be included. He recalled that the commission had considered looking solely at assets as a means to determine a person's ability to absorb loss, but that that option was rejected. Poxson stated that there was no discussion as to the meaning of the term net worth, its application or rationale, or whether net worth was indicative of financial condition. Poxson recalled that it was the committee actuary that devised the formula which caused the net worth limit to fluctuate based on permiums written by member insurers. He also recalled a comment, at one point, that "nobody feels sorry for General Motors."

Poxson, as general counsel for Michigan Mutual, testified that during committee discussions he was concerned about the impact of the assessment on Michigan Mutual and therefore wanted to limit the assessment to 1% of net direct premiums. The proposed model bill submitted to the NAIC by the Trade Association, which bill had been obtained by Poxson, was modified to include a net worth limitation based on 1/10th of 1% of net direct premiums, and a maximum annual assessment of 1% of net direct premiums. This bill was introduced in the Michigan legislature as a substitute bill with some minor changes on May 2, 1969, and was enacted and became law on August 11, 1969. There was no testimony or evidence introduced in court concerning discussions by any committee or by the legislature regarding the net worth limitation, other than the above described testimony of Poxson.

Opinion

The parties agree that the net direct premiums written in the state, net worth limitation, and maximum covered claims under the Act for the years 1977-1987 were:

Year	Premiums Written	Net Worth Limit	Maximum Claim
1977.....	$3,330,832,000	$3,330,832	$1,665,416
1978.....	$3,913,666,000	$3,913,666	$1,956,833
1979.....	$4,326,290,000	$4,326,290	$2,163,145
1980.....	$4,323,174,000	$4,323,174	$2,161,587
1981.....	$4,205,984,000	$4,205,984	$2,101,992
1982.....	$4,041,943,000	$4,041,943	$2,020,972
1983.....	$4,207,312,000	$4,207,312	$2,103,656
1984.....	$4,696,500,000	$4,696,500	$2,348,250
1985.....	$5,820,973,000	$5,820,973	$2,910,487
1986.....	$7,262,697,000	$7,262,697	$3,631,349
1987.....	$7,676,669,000	$7,676,669	$3,838,335

The parties agree that the net worth of Borman's, as of the end of the fiscal years ending January, 1980, through January, 1988, was:

Y/E January 26, 1980	$32,557,000
Y/E January 31, 1981	$32,006,000
Y/E January 30, 1982	$28,262,000
Y/E January 29, 1983	$35,304,000
Y/E January 28, 1984	$23,901,000
Y/E January 26, 1985	$22,797,000
Y/E January 25, 1986	$30,135,000
Y/E January 31, 1987	$38,783,000
Y/E January 30, 1988	$10,110,000
3rd Qtr. Nov 5, 1988	$ (870,680)

The parties agree that for the period May 1, 1980, to May 1, 1984, Borman's primary general liability and auto insurance carrier was Ideal Mutual Insurance Company (Ideal), a New York company. Each of the policies which Ideal issued to Borman's had a combined single limit of $950,000 per occurrence, in excess of $50,000 per occurrence retained limit. According to trial testimony, Borman's purchased the Ideal insurance through Marsh and McLennan, identified as one of the largest insurance brokers in the country.

On February 7, 1985, the Supreme Court for the State of New York, County of New York, entered an order in a case entitled ***In the Matter of the Application of James P. Corcoran, as***

Superintendent of Insurance of the State of New York, for an Order to Take Possession and Liquidate the Business and Affairs of Ideal Mutual Insurance Company, Index No. 40275-85. The order stated that Borman's insurer, Ideal, was insolvent. The order appointed the New York Superintendent of Insurance as liquidator of Ideal to forthwith take possession of Ideal's property and liquidate the business and affairs of Ideal under the Uniform Insurer's Liquidation Act, as adopted in New York.

Ideal was a "member insurer" of the Michigan Property & Casualty Guarantee Association and an "insolvent insurer" as defined in the Act. MCL 500.7921. On March 25, 1985, the Michigan Commissioner of Insurance was appointed Ancillary Receiver of Ideal.

On August 7, 1981, Norris Frye had filed a complaint against Borman's in the Wayne County Circuit Court, State of Michigan, alleging damages arising out of a slip and fall which occurred at a Farmer Jack Store during August of 1980. The case proceeded through discovery and trial. On September 24, 1984, the Wayne County Circuit Court entered a judgment on a jury verdict against Borman's for $1.5 million plus interest of $638,569.00.

The Frye judgment against Borman's was covered under the Ideal policy. Subsequent to entry of the judgment, Ideal agreed to pay a minimum of $950,000 towards settlement of the Frye judgment. However, on December 26, 1984, the New York Supreme Court entered an order of rehabilitation. The order of rehabilitation and subsequent order of liquidation (entered on February 7, 1985) enjoined disposition of Ideal's property and enjoined further prosecution of any action. As a result of Ideal's failure to pay its share of the agreed settlement of the Frye judgment, Borman's was required to contribute approximately one million dollars toward settlement of the Frye matter.

The Michigan Commissioner of Insurance, as Ancillary Receiver of Ideal, sent a notice to all Ideal policyholders and claimants in Michigan notifying them that all claims under the Act must be filed by February 7, 1986. Borman's filed a timely claim regarding the Frye judgment.

The Association declined to honor Borman's claim, however, based on the determination that Borman's net worth exceeded the

statutory formula on the date of the liquidation order. MCL 500.7925(3).

The Proofs

The Michigan Insurance Bureau monitors the financial condition of insurance companies doing business in Michigan. During trial, the testimony of Jacqueline Reese was introduced. Reese is an auditor employed by the Department of Licensing and Regulation, Insurance Bureau, Financial Analyst Division, and she was the auditor in charge of the Ideal account during the years in question. During her testimony, Reese stated that the function of the auditors is to audit the financial statements of insurance companies in order to determine their financial solvency. The goal is to insure financial solvency of insurance companies for Michigan policyholders and residents. The aim of the financial analyst division is to prevent further injury to Michigan policyholders and residents by placing restrictions on companies which are in financial difficulty. These restrictions might include: premium limitations, policy limitations, suspension of writing policies, and cease and desist orders. Reese audited Ideal's financial information on a quarterly and annual basis from 1980 through its insolvency. Reese was satisfied that Ideal was not a risk to the public based on its 1980, 1981, and 1982 financial information, and the follow-up information that Reese requested from Ideal. Reese did not recommend imposing any restrictions on Ideal until 1984. She was of the opinion that Ideal was not in any financial difficulty until the 1983 year-end information was audited during the first quarter of 1984. According to Reese, the first time the Insurance Bureau informed Ideal that it was considering imposing restrictions was mid-1984, and the first time that the Insurance Bureau imposed restrictions on Ideal was August 17, 1984. The restrictions issued against Ideal in August, 1984, included a prohibition against the writing of new business without prior written approval by the Bureau and the requirement of a special deposit. The August, 1984, restrictions were informal agreements and were not communicated to the public.

According to the testimony of Lawrence Sullivan, president of a risk management services company, the *Best's Key Rating Guide (Best's)*, published by A.M. Best Company, was the most commonly used source in the insurance industry for rating the financial stability of insurance companies during the time period

in question. Sullivan stated that it was reasonable for insureds and insurance brokers to rely on *Best's* in choosing insurance companies and also to rely on the grant of a license by the state insurance regulators.

Ideal was rated as follows by *Best's*:

1980	B+
1981	A
1982	A
1983	Contingent A

Best's defines a B+ as: very good — assigned to those companies which have achieved very good overall performance when compared to the norms of the property-casualty insurance industry. On a relative basis insurers rated B+/very good generally have demonstrated a very good ability to meet policyholder and other contractual obligations. *Best's* defined A as: excellent — assigned to those companies which *Best's* finds to have achieved excellent overall performance when compared to the norms of the property/casualty insurance industry. On a relative basis, insurers rated A/excellent generally have demonstrated a strong ability to meet their respective policyholder and other contractual obligations. "Contingent" is assigned temporarily to a company when there has been a decline in performance, in its profitability, leverage, and/or liquidity, but the decline has not been significant enough to warrant an actual reduction in the company's previously assigned rating.

Net worth is not defined in the Act nor is a formula or standard procedure prescribed for determining net worth.

Borman's introduced the testimony of David Simmons, a partner with Touche Ross & Co., as an expert witness. According to Simmons, the commonly accepted meaning of "net worth" is the balance sheet entry which shows recorded assets in excess of recorded liabilities. Defendant agrees with this definition.

Simmons testified that the net worth of a person or company may change radically from year to year based upon factors entirely within or outside their control. Factors within their control include, for example, a declaration of dividends, sale or acquisition of assets, leveraged buyout, restructuring of capital, changes in accounting practices, changes in tax reporting, revaluation of assets, etc. Factors outside their control include, for

example, labor strike, market conditions, shortage of raw product, the economy, unanticipated loss, mandated changes in accounting methods, tax law changes, etc. According to Simmons, net worth is not determinative of the ability of an insured to absorb loss in the event of its insurer's insolvency.

Sullivan, the president of the risk management services company, agreed with Simmons, stating that there was no relationship between net worth and ability to absorb loss.

During the course of the testimony of Robert Epstein, General Counsel of Borman's, a comparison was made for the years 1984-1987, between the sales, total assets, and net worth of Borman's and those of Safeway Stores, identified as once the largest supermarket chain in the world. The following figures were offered as evidence:

Company	Date	Total Assets	Sales	Net Worth
Borman's	01/26/85	140,390,383	1,025,920,000	22,797,000
Safeway	12/29/84	4,537,229,000	19,642,201,000	1,469,023,000
Borman's	01/25/86	148,245,599	987,188,000	30,135,000
Safeway	12/28/85	4,840,611,000	19,650,542,000	1,622,614,000
Borman's	01/31/87	175,401,725	1,072,998,137	38,783,000
Safeway	01/03/87	7,443,877,000	20,311,480,000	2,902,000
Borman's	01/30/88	229,376,865	1,028,254,713	10,110,000
Safeway	01/02/88	4,917,479,000	18,301,625,000	(461,827,000)

According to both Epstein and Simmons, the decrease in the net worth of Safeway from $1,622,614,000 in December, 1985, to $2,902,000 in January, 1987, and a negative ($461,827,000) in January, 1988, was the result of a leverage buyout and changes in accounting practices, and not a change in business conditions. Under the Act, Safeway, with many times the sales and assets of Borman's, would have its claims covered while Borman's would not. Simmons stated that the fact that Safeway's net worth was a negative ($461,827,000) as of January 2, 1988, did not mean that it could not absorb loss or that its ability to do so was less than Borman's, which at that time had a net worth of about $10 million. According to Simmons, change in net worth does not mean that a company has experienced a change in profitability or a change in its operations.

The testimony of defendant's accounting expert Julius Otten, a partner at Peat, Marwick, is consistent with Simmon's opinion in this respect. Otten described a company which the Association had found to be entitled to coverage under the Act in accordance

with the Act's net worth provision. That company, as of its March 31 year-end, had a net worth over $6,400,000. In the ensuing year it had revenues of over $68,000,000 and an operating profit of over $3,200,000. Yet its net worth dropped from $6,400,000 to $700,000. This drop in net worth was not attributable to financial reverses but, rather, to the fact that the company bought back its own stock and established an employee stock ownership trust. The difference in net worth was not related to the financial condition of the company or its ability to absorb loss.

Epstein testified that had Borman's changed its accounting method for inventory from LIFO to FIFO on November 5, 1988, a change that Borman's had seriously considered, its net worth as reflected on its balance sheet would have been a positive $15.8 million instead of a negative $870,000, an increase of more than $16 million. Assuming Borman's insurance carrier were to become insolvent in 1989, Borman's could recover from the Association if it continued to use a LIFO accounting method for valuing inventory, but if it merely changed to a FIFO method, Borman's could not recover from the Association. This difference in net worth had nothing to do with the financial condition of Borman's or its ability to absorb loss.

Simmons testified that financial condition can only be assessed by understanding each of the elements of the financial statement. The assets of a company must be analyzed, i.e., a receivable's age bears upon its value, and the method of accounting for inventory bears upon its value. Assets must also be analyzed to determine whether they are tangible or intangible. Goodwill, an intangible asset, is allowed under Generally Accepted Accounting Principles (GAAP), but is not a liquid asset and could not be used to absorb an unexpected loss. Similarly, the liabilities must be analyzed. Loan agreements may restrict uses of cash or may require that the company maintain certain ratios, which if not maintained could result in default and foreclosure. There may be obligations to employees under a collective bargaining agreement which impact on the financial condition of the company. In order to assess the financial condition of a company, one must also understand the industry and trends affecting the industry.

Simmons also testified regarding a "typical" real estate venture where the value of the asset (e.g. office building) is

reported at acquisition cost less depreciation, resulting in a reduction in its value over time even though the market value of the asset may be substantially increasing during the same period. The increase in market value is normally not reflected on the balance sheet while the depreciation is. In this example, while the business may be profitable and the market value of the office building substantially increasing, the net worth continues to decline.

Another "typical" example introduced by plaintiff related to ownership of a shopping center or hotel venture. Often the owner will form a management company to operate the facility and obtain the insurance. Since it is the operating company which is at risk, typically it will be the operating company which will be sued as a result of a loss. Since the operating company has little, if any, assets, it will be covered under the Act. This results even though there is usually an identity of ownership between the operating company and the owner of the shopping center or hotel, and such owner may have a net worth substantially in excess of the net worth limitation.

The Association's accounting expert, Julius Otten, agreed that the real estate example and the management company example are typical. Otten also agreed that net worth may be radically different depending on the method of reporting utilized (i.e. cash, accrual, or tax basis) or on factors totally within the control of the company (such as a repurchase of stock). He also agreed that net worth does not show profitability. Otten felt, however, that it is rational to use net worth alone as the indicator of ability to absorb loss because, while net worth may be an imperfect measurement resulting in real or perceived inequities, net worth is an indicator of capacity to absorb loss which is generally understood and easily determined.

The Association asserted that both insurance companies and banks are examples which support the Association's position that a company's net worth indicates its ability to absorb loss. These businesses are heavily regulated, however, and their financial statements are governed by statute. Further, the testimony of the witnesses does not support the defendant's argument. For example, Otten, the Association's witness, testified that insurance companies typically prepare two financial statements — one conforming to statutory requirements and one prepared in accordance with GAAP. Otten stated that the net worth figure on the

two statements, covering precisely the same period of time, could be radically different. This example, therefore, ultimately provides further support for plaintiff's position that net worth, standing alone, is not a valid indicator of a company's ability to absorb loss.

Plaintiff's witness, Simmons, also testified that the net worth figures for insurance companies and banks are without meaning in this context. According to Simmons, one would need to evaluate reinsurance, reserves, agents' balances, and other matters in assessing the financial condition of an insurance company. With respect to banks, one would need to know, among other things, the types of loans that the bank had issued and the types of assets owned. Sullivan also stated that he would not rely on the net worth of an insurance company to show its financial condition.

George Gottheimer, Jr., the Association's witness, has worked for or on behalf of insurance companies throughout his 35-year career. It is Gottheimer's opinion that "given the limited resources that are available, . . . the institution of a net worth exclusion is a reasonable and rational one, and that the net worth in and of itself is not perhaps a perfect measurement of a persons wealth. I think it is one that is easily determinable, easy to administer, and it is probably the best measure of the ability of a person to absorb loss." When questioned by the court, Gottheimer stated that while the net worth figure may paint a certain picture, it could vary from day to day and it does not tell you about liquidity and collectibility of assets. When asked by the court whether one needs to look at things other than net worth in assessing financial condition, Gottheimer responded that net worth is easy to administer, and that that is why he believes the legislature adopted the net worth provision.

Jean Carlson, the deputy commissioner for policy at the Michigan Insurance Bureau, agreed in her testimony that the attractiveness of utilizing net worth is the ease in administration. When cross examined, Carlson admitted that she could tell nothing real about the financial condition of a company knowing only its net worth.

Gloria Freeland, claims manager for the Association, testified that her job would be more difficult if there were no net worth provision because there would be more claims.

Opinion

James Lunstead, the controller for the Association, testified about the balance sheet of the Association from inception to September, 1988. Lunstead was asked whether, based on the Association's net worth, the Association would be able to cover claims in the event of another major insolvency. Lunstead responded that, just looking at net worth, one cannot get a true economic or financial picture.

In addition to claiming that an entity's net worth is indicative of its ability to absorb loss, the Assocation argues that those entities with a higher net worth can better analyze the financial condition of insurance companies. Defendant's expert, Gottheimer, testified that "wealthier persons" were in a better position to evaluate the financial condition of insurance companies because they can better review the financial statements or hire someone with the expertise to do so. Plaintiff disagrees, however, arguing that net worth is not related to the ability of an insured to predict the insolvency of its insurer.

As noted above, Ideal was rated by *Best's* as B+ in 1980, A in 1981-1982, contingent A in 1983, and was not in any way restricted by the Michigan Insurance Bureau (M.I.B.) until mid-1984. The M.I.B., which audited the financial statements of Ideal, determined that Ideal did not pose a danger to the public until mid-1984. Yet, by the end of that same year, Ideal was placed in rehabilitation and, in early 1985, Ideal was declared insolvent.

According to testimony at trial, insurance company financial statements are reviewed by *Best's* and by the M.I.B. Copies of reports issued by *Best's* and state insurance regulators are available to all interested persons irrespective of net worth. Further, while large companies may have risk managers, no evidence was presented showing that these persons are better able than *Best's* or the state regulators to assess the future financial picture of an insurance company so as not to need the protection of the Guaranty Association. Plaintiff introduced exhibits showing that many large companies with net worths over the Act's limit have had insurance with companies which became insolvent.

The Association also argued that the fact that Borman's had a self-insured retention of $50,000 per occurrence indicates that Borman's is better able to absorb loss than is an entity which has first dollar insurance. However, defendant did not establish a direct relationship between net worth and the amount of

self-insurance retention. Indeed, as Epstein and Sullivan pointed out, Borman's net worth in November of 1988 was $39 million less than what it was in January, 1987, while its self-insured retention had doubled to $100,000.

Analysis

It is plaintiff's position that section 500.7925(3) of the Act, which denies reimbursement of claims filed by ". . . a person who has a net worth greater than 1/10th of 1% of the aggregate premiums written by member insurers in the state in the preceding calendar year," denies plaintiff's right to equal protection of the law, as guaranteed by the fourteenth amendment to the United States Constitution, and by article I, section 2, of the Michigan Constitution.

The parties agree that the net worth classification of section 500.7925(3) does not involve a fundamental right or suspect classification meriting "strict scrutiny" by the court. Rather, the legislation in question is economic in nature and, therefore, subject to the "rational basis" test. *See Cleburne v. Cleburne Living Center*, 473 U.S. 432, 440 (1985). Application of the rational basis test requires an analysis of the purpose of the legislation in question, and a determination of whether the classification contained in that legislation bears a rational relationship to its purpose. *Borden's Farm Products Co. v. Baldwin*, 293 U.S. 194 (1934).[2]

The dispute between the parties centers on the constitutionality of the section 500.7925(3) classification of persons entitled to recover under the Act, i.e., classification of persons based upon their net worth. The only evidence submitted to the court regarding the purpose of the net worth limitation was presented through the testimony of the Association's witness, Elijah Poxson. According to Poxson, the purpose of the net worth limitation was to

---

[2]Plaintiff asserts that the test to be applied under Article I, section 2, of the Michigan Constitution is whether the net worth exclusion bears a fair and substantial relationship to the object of the Act. *See Manistee Bank & Trust Co. v. McGowan*, 394 Mich. 655, 232 N.W.2d 636 (1975). This test and the rational basis test under the fourteenth amendment to the United States Constitution are virtually indistinguishable. Therefore, the court will confine its discussion in the text to the rational basis test under the United States Constitution, and the court's conclusions shall apply with equal force to plaintiff's arguments rgarding [sic] its right to equal protection under the Michigan Constitution.

allocate loss to those persons best able to absorb loss.[3] There was no evidence submitted to the contrary, and there was no real dispute between the parties regarding the purpose of section 500.7925(3) or the legitimacy of this purpose. Rather, the arguments and proofs submitted by the parties centered upon their respective attempts to negate or to support the existence of any rational relationship between one's net worth and ability to absorb loss.

In challenging the constitutionality of section 500.7925(3), plaintiff has the heavy burden of convincing the court that "the legislative facts on which the classification is apparently based could not reasonably be conceived to be true by the governmental decisionmaker." *Vance v. Bradley*, 440 U.S. 93, 111 (1979), (citing *Lindsley v. Natural Carbonic Gas Co.*, 220 U.S. 61, 78-79 (1911)). Further, "[a]lthough parties challenging legislation under the Equal Protection Clause may introduce evidence supporting their claim that it is irrational, . . . they cannot prevail so long as 'it is evident from all the considerations presented to [the legislature], and those of which we may take judicial notice, that the question is at least debatable.'" *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 464 (1981) (citation and footnote omitted) quoting *United States v. Carolene Products Co.*, 304 U.S. 144, 154 (1983)). However, "[t]he State may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational." *Cleburne*, 473 U.S. at 446 (citing *Zobel v. Williams*, 457 U.S. 55, 61-63 (1982) and *United States Dept. of Agriculture v. Moreno*, 413 U.S. 528, 535 (1973)).

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[3]Plaintiff asserts that the purpose of the Act is "to protect from potentially catastrophic loss persons who have a right to rely on the existence of an insurance policy. . . ." *Metry v. Michigan Property & Casualty Guarantee Ass'n*, 403 Mich. 117, 121, 267 N.W.2d 695 (1978). In making this statement, the *Metry* court was drawing a distinction between insureds, whom the Act was designed in general to protect, and law firms seeking reimbursement under the Act for fees incurred in providing legal services to insolvent insurers prior to insolvency. The *Metry* court ultimately concluded that the fees sought for legal services were not "covered claims" within the meaning of the Act.

In the instant case, the plaintiff is challenging specifically the net worth provision set forth in section 500.7925(3) of the Act. Therefore, it is the purpose of section 500.7925(3) which is relevant to this dispute, and the court finds the purpose to be one which is consistent with the overall purpose of the Act as described in *Metry*.

Opinion

Conflicting testimony was introduced at trial. For example, defendant's accounting expert, Julius Otten, testified that, in his opinion, it is rational to use net worth alone as the indicator of ability to absorb loss. According to Otten, although net worth may be an imperfect measurement resulting in real or perceived inequities, net worth is a generally understood and easily determined indicator of capacity to absorb loss. In contrast, according to the testimony of plaintiff's accounting expert, David Simmons, net worth is not an indicator of the ability of an insured to absorb loss. In light of this and other conflicting evidence introduced at trial, defendant argues that the rationality of the relationship between a person's net worth and that person's ability to absorb loss "is at least debatable," and therefore passes the rational basis test. *Clover Leaf.*

Plaintiff, on the other hand, interprets the evidence to show that the relationship between net worth and ability to absorb loss "is so attenuated as to render the distinction arbitrary and irrational." *Cleburne.* In support of its argument, plaintiff points to the uncontroverted evidence regarding: 1) the "typical" real estate venture where the value of the asset (e.g., office building) is reported at acquisition cost less depreciation, resulting in a reduction in the asset's value over time even though the market value of the asset may be substantially increasing during the same period; 2) the "typical" shopping center or hotel venture where a management company is formed to operate the facility and obtain insurance, and where that management company meets the Act's net worth limitation despite the identity of ownership between the management company and the owner of the shopping center or hotel, which may not meet the Act's net worth limitation; 3) the extreme decrease in the net worth of Safeway Stores, Inc., occurring over the three year period from December, 1984, to January, 1988, as the result of a leveraged buyout and changes in accounting practices, and not as the result of a change in business conditions or the ability of Safeway to absorb loss; 4) the fact that a person's net worth may change radically from year to year based upon factors entirely within their control (i.e., declaration of dividends, sale or acquisition of assets, leveraged buyout, restructuring of capital, changes in accounting practices, changes in tax reporting, revaluation of assets, etc.) and/or upon factors entirely outside their control (i.e., labor strike, market conditions, shortage of raw product, the economy, unanticipated loss, mandated

changes in accounting methods, tax law changes, etc.); and 5) the fact that a single company at any fixed point in time can have a dramatically different net worth based merely upon, for example, a change in its accounting method for inventory from LIFO to FIFO.

After careful consideration of the pleadings submitted, the proofs introduced at trial, the parties' arguments heard in open court, and the law relating to this issue, the court agrees with the plaintiff's position and finds that the classification of persons and entities entitled to recover from the Association, based solely upon their net worth at a given time, is arbitrary and is not a classification which is rationally related to the Michigan legislature's purpose of allocating loss to those best able to absorb loss. The court is also satisfied, with regard to the defendant's alternative or supporting argument, that plaintiff has shown that there is no meaningful relationship between net worth and the ability of a person or entity to predict the insolvency of an insurer.

The court therefore concludes that section 500.7925(3), as it applied to plaintiff, violates plaintiff's right to equal protection under the law as provided by both the United States and Michigan Constitutions. Defendant is ordered to pay and discharge the claim filed by plaintiff which arose out of the slip and fall accident involving Norris Frye.

Nonretroactivity

In *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), the Supreme Court enunciated three separate factors to be considered in determining whether a judicial decision should be applied nonretroactively.

> [I]n the last few decades, we have recognized the doctrine of nonretroactivity outside the criminal area many times, in both constitutional and nonconstitutional cases. *Cipriano v. City of Houma,* 395 U.S. 701, 89 S.Ct. 1897, 23 L.Ed.2d 647; *Allen v. State Board of Elections,* 393 U.S. 544, 89 S.Ct. 817, 22 L.Ed.2d 1; *Hanover Shoe, Inc. v. United Shoe Machinery Corp.,* 392 U.S. 481, 88 S.Ct. 2224, 20 L.Ed.2d 1231; *Simpson v. Union Oil Co.,* 377 U.S. 13, 84 S.Ct. 1051, 12 L.Ed.2d 98; *England v. State Board of Medical Examiners,* 375 U.S. 411, 84 S.Ct. 461, 11 L.Ed.2d 440; *Chicot*

> *County Drainage Dist. v. Baxter State Bank,* 308 U.S. 371, 60 S.Ct. 317, 84 L.Ed. 329.
>
> In our cases dealing with the nonretroactivity question, we have generally considered three separate factors. First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, *see e.g., Hanover Shoe, Inc. v. United Shoe Machinery Corp., supra,* 392 U.S. at 496, 88 S.Ct., at 2233, or by deciding an issue of first impression whose resolution was not clearly foreshadowed, *see, e.g., Allen v. State Board of Elections, supra,* 393 U.S., at 572, 89 S.Ct., at 835. Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." *Linkletter v. Walker, supra,* 381 U.S., at 629, 85 S.Ct. at 1738. Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity." *Cipriano v. City of Houma, supra,* 395 U.S., at 706, 89 S.Ct., at 1900.

Id. at 107-108.

An equal protection challenge to an insurance act provision which determines eligiblity for reimbursement of claims based on net worth, has not, to this court's knowledge, previously been litigated. Nor was the resolution of this matter clearly foreshadowed by prior court decisions. Also, the purpose of the Act's net worth provision, *i.e.*, to shift loss to those best able to absorb loss, would not be furthered by retroactive application of this court's ruling since it is unclear under the net worth criterion whether those who have previously been denied reimbursement were or were not "best able to absorb loss." Finally, retroactive application of this court's decision could produce substantial inequitable results because insureds were on notice that the Act contained its net worth restriction, and the Association would likely suffer a severe depletion of its funds if it was now forced to reimburse each claimant who had previously been denied reimbursement under the Act on the basis of that claimant's net worth.

Accordingly, the court's ruling in this matter shall be applied prospectively. *Accord DiFranco v. Pickard*, 427 Mich. 32, 75, 398 N.W.2d 896 (1986).

IT IS SO ORDERED.

(s) BARBARA K. HACKETT
UNITED STATES DISTRICT JUDGE

Dated: June 30, 1989

A TRUE COPY
Clerk, U.S. District Court
Eastern District of Michigan

(s) LISA TEETS
Deputy Clerk

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

BORMAN'S, INC., a
Delaware corporation,
Plaintiff,

CASE NO. 86-CV-70122-DT

vs.

HON. BARBARA K. HACKETT

MICHIGAN PROPERTY & CASUALTY
GUARANTY ASSOCIATION, a
Michigan association,
Defendant.

_____/

ORDER DENYING CROSS-MOTIONS FOR SUMMARY JUDGMENT

Plaintiff Borman's, Inc. brought suit requesting a declaratory judgment that a Michigan statute violated the equal protection clause of both the Michigan and United States Constitutions.

With certain narrow exceptions, all insurance companies authorized to transact business in this state are required to be members of the Michigan Property & Casualty Guaranty Association (Association) which has been created pursuant to the Michigan Property & Casualty Guaranty Association Act (Act). Mich. Comp. Laws § 500.7901 *et seq.* The Act's purpose is to create a fund whereby claims arising out of insurance policies issued by now insolvent insurance companies can be satisfied. The Act specifically provides a net worth limitation which excludes satisfaction of claims when the insured has a net worth in excess of a specified amount. Mich. Comp. Law § 500.7925(3).

Plaintiff has a claim arising out of an insurance policy issued by a now insolvent insurance company but, because plaintiff's assets exceed the net worth limitation provided by this statute, its claim will not be satisfied. Plaintiff contends that this is discriminatory lack of protection which violates its rights to equal protection under both state and federal law.

This matter is presently before the court on cross-motions for summary judgment. Both parties concede that the rational basis standard of review is appropriate in this lawsuit. If it is conceivable that the net worth classification bears a rational relationship to

furthering a legitimate state purpose, defendant will prevail. Plaintiff bears the heavy burden of overcoming the presumption of constitutionality and must negate every conceivable or reasonable basis which might support this discriminatory classification. *Usery v. Turner Elkhorn Mining co.*, 428 U.S. 1 (1976). The court must uphold the statute if "any state of facts either known or which could reasonably be assumed affords support for it." *Johnson v. Harnischfeger Corp.*, 414 Mich. 102 (1982); in accord *Dandridge v. Williams*, 397 U.S. 471 (1970).

Plaintiff contends that a legitimate state purpose was articulated by the Michigan Supreme Court and is "to protect from potentially catastrophic loss persons who have a right to rely on the existence of an insurance policy." *Metry, Metry, Sanom & Ashare v. Michigan Property & Casualty Guaranty Ass'n.*, 403 Mich. 117 (1978). Since any conceivable legislative purpose will suffice, this stated purpose of the legislation is acceptable. The problem does not arise in agreeing on a legitimate state purpose. It arises in deciding whether the net worth classification is rationally or reasonably related to furtherance of any articulated state purpose.

Defendant submits that it is reasonable to assume that those most in need of protection from catastrophic loss are those whose assets fall below the statutory classification scheme of the Act. In countering this assertion, plaintiff argues that discrimination based on net worth does not further the policy of protecting insureds from catastrophic loss. An insured with a net worth above the statutory limit could suffer a casualty loss of such magnitude that all of its assets could be lost. In this example, the wealthy insured would suffer a catastrophic loss and would be totally without recourse. Therefore, this classification scheme is not rational.

Both parties have asked in their cross-motions that the court resolve the issue of whether the classification scheme is rationally or reasonably related to furthering a legitimate state policy. They offer the court voluminous authority going to the merits of their positions but fail to offer one citation to support the argument that a determination of rational or reasonable relationship is one of law, not fact. In fact, the case law found by the court is in direct conflict with the arguments advanced by both parties.

Order Denying Cross-Motions For Summary Judgment

In *Metropolitan Life Insurance Co. v. W.G. Ward, Jr.*, 470 U.S. 869 (1985), out-state insurance companies challenged an Alabama statute that imposed lower tax rates on domestic companies. At the trial level the state statute was upheld on a motion for summary judgment. The state court found two legitimate state purposes and "also found that the distinction the statute created between foreign and domestic companies was rationally related to those two purposes. . . ." *Id.* at 1679. On appeal, the Court of Civil Appeals of Alabama affirmed as to the existence of the two legitimate state purposes but remanded for an evidentiary hearing on the issue of rational relationship concluding that summary judgment was inappropriate. *Metropolitan Life Insurance Co. v. Forrester*, 437 So.2d 535 (Ala. Civ. App. 1983). The argument advanced and adopted was that the trial court committed error in granting summary judgment on the issue of whether it was reasonable to believe that the "classification would promote the legitimate purposes. . . . They contend that such reasonableness was an issue of material fact placed in dispute by the affidavits of the various experts." *Id.* at 539. In accord is *Wartham v. City of Tucson*, 128 Ariz. 137, 624 P.2d 334 (1981).

Concededly, these cases do not bind this court but at least they offer some guidance on this issue. Clearly, whether there is a rational relationship is in dispute factually. This court has not been pursuaded that this issue should be resolved as one of law and agrees that the "presumption of constitutionality afforded legislative enactments was not intended to prevent the full factual development of the challenge of the rationality of the action of the legislature in pursuing its stated or conceivable purpose." *Metropolitan Life Insurance Co.*, 437 So.2d at 540. Accordingly,

IT IS ORDERED that the parties cross-motions for summary judgment are denied.

(s) BARBARA K. HACKETT
UNITED STATES DISTRICT JUDGE

Dated: December 9, 1987

500.7911. Maintenance of association; membership, requirement; laws applicable to association

Sec. 7911. (1) To implement this chapter, there shall be maintained within this state, by all insurers authorized to transact in this state insurance other than life or disability insurance, except the Michigan basic property insurance association created pursuant to section 2920, the Brown-McNeely insurance fund created in section 2502(1), an association of those insurers to be known as the property and casualty guaranty association, hereafter referred to as the "association". Each insurer shall be a member of the association, as a condition of its authority to continue to transact insurance in this state.

(2) An insurer from which insurance has been or may be procured in this state solely by virtue of sections 1901 to 1955[3] shall not be considered to be an insurer authorized to transact insurance in this state, for the purposes of this chapter.

(3) The association shall be subject to the requirements of this chapter and of chapter 78, but shall not be subject to the other chapters of this act. The association shall be subject to other laws of this state to the extent that it would be subject to those laws if it were an insurer organized and operating under chapter 50, to the extent that those other laws are consistent with this chapter.

500.7912. Management of association; board of governors, members, terms, vacancies

Sec. 7912. (1) The association shall be managed by a board of governors, composed of 5 member insurers and 2 persons representing the general public, each of whom shall be appointed by the commissioner to serve for terms of 3 years and until their successors are appointed and qualified. Three of the governors who are member insurers shall be domestic insurers and 2 shall be foreign insurers. At least 2 governors who are member insurers shall be stock insurers and at least 2 shall be nonstock insurers. The 5 governors who are member insurers shall be representative, as nearly as possible, of all the kinds of insurance covered by this chapter.

500.7925. Covered claims, definition

* * *

(4) Covered claims shall not include any portion of a claim which is in excess of an applicable limit provided in the insurance policy.

(5) Covered claims shall not include that portion of a claim, other than a worker's compensation claim, which is in excess of 1/20 of 1% of the aggregate premiums written by member insurers in this state in the preceding calendar year.

* * *

500.7941. Assessments upon member insurers, purposes, basis, rate payment, disposition

Sec. 7941. (1) To the extent necessary to secure funds for the association for payment of covered claims and for payment of reasonable costs of administering the association, including the cost of indemnifying members of the board of governors, other member insurers, officers, employees, and other persons acting on behalf of the association to the extent permitted by law and the plan of the operation, the association shall levy assessments upon all member insurers. The association shall allocate its claim payments and costs to the following 5 categories:

(a) Worker's compensation insurance.

(b) Automobile insurance.

(c) Title insurance.

(d) Fire, allied lines, farm owner's multiple peril, homeowner's multiple peril, inland marine, earthquake, and credit insurance.

(e) All other kinds of insurance except life and disability insurance.

(2) Separate assessments shall be made for each category prescribed in subsection (1). The assessment for each category shall be used to pay the claim payments and costs allocated to that category. The assessment for each category shall be in proportion to the net direct premiums written, after deducting dividends paid or credited to policyholders, by each member insurer in this state for kinds of insurance included within each

category, as reported in the most recent annual statement available at the time of assessment. The rate of assessment shall be a uniform percentage of the premiums for all member insurers. The assessments shall be remitted to and administered by the association in accordance with the plan of operation. Each member insurer assessed shall have not less than 30 days' advance written notice of the date the assessment is due and payable.

(3) A member insurer shall not be assessed during a calendar year for more than 1% of its net direct premiums written in this state during the previous calendar year. The commissioner may exempt a member insurer from all or part of an assessment or may defer, in whole or in part, the assessment of a member insurer, if the assessment would cause the member insurer's financial statement to reflect amounts of capital or surplus less than the minimum amounts required for a certificate of authority by any jurisdiction in which the member insurer is authorized to transact insurance. However, during the period of exemption or deferment, dividends shall not be declared or paid to shareholders or policyholders. If a member insurer is exempted from all or part of an assessment, or if an assessment against a member insurer is deferred in whole or in part, the amount of the exemption or deferred assessment may be assessed against the other member insurers in a manner consistent with the basis for assessments prescribed in this section. The commissioner may impose conditions on an exemption or deferral which he or she considers reasonable and necessary.

(4) The assessments shall be recognized in the rate-making procedures for insurance rates in the same manner that expenses and premium taxes are recognized. Unused assessments and reimbursements from the receiver remaining in a category in excess of covered claims and expenses allocated to that category shall be refunded by the association to each member insurer who paid the assessments for that category in proportion to its assessments paid. An insurer which ceases to be a member of the association shall not have a right to a refund of an assessment previously remitted to the association. The commissioner may revoke the certificate of authority to transact business in this state of a member insurer which fails to pay an assessment when due as provided in this act and after a demand has been made.

Supreme Court, U.S.
FILED
JUN 23 1991
OFFICE OF THE CLERK

No. 90-1965

In The

Supreme Court of the United States

October Term, 1991

BORMAN'S, INC.,

Petitioner,

v.

MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

BRIEF OF THE MICHIGAN PROPERTY & CASUALTY GUARANTY ASSOCIATION IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF THE QUESTIONS PRESENTED

In 1969, the Michigan legislature enacted a statute creating the Michigan Property & Casualty Guaranty Association. The Association was created to pay certain, but not all, obligations (called "covered claims") of insolvent property/casualty insurers to their Michigan insureds and to persons with claims against Michigan insureds. Recognizing that it was appropriate, given the limited resources available to the Association, to restrict the payment of claims to those asserted by persons least able financially to absorb an unexpected and uninsured loss, the legislature enacted a provision in the 1969 statute excluding from the definition of a "covered claim" "obligations to . . . a person who has a net worth greater than 1/10 of 1% of the aggregate premiums written by member insurers" in Michigan in the calendar year preceding insolvency.

In this challenge to the "net worth" provision under the Equal Protection Clause of the United States Constitution, the questions presented are as follows:

> 1. Where the district court characterized its conclusion on the constitutional issue as a "finding" but did not determine any disputed issues of fact and where, in any event, the court of appeals accepted the factual record developed in the district court, was the court of appeals bound by Fed. R. Civ. P. 52(a) to accept the district court's conclusion that there is no rational relationship between a person's net worth and his or her relative ability to absorb an uninsured loss?

COUNTERSTATEMENT OF THE QUESTIONS PRESENTED – Continued

2. Did the court of appeals correctly hold – given the admittedly conflicting evidence on the question whether there is a rational relationship between net worth and the relative ability to absorb an uninsured loss – that the net worth provision is constitutional and that the district court improperly substituted its judgment for that of the legislature in concluding otherwise?

LIST OF PARTIES AND RULE 29.1 STATEMENT

The parties to the proceedings below were Petitioner and Respondent.

The Petitioner is Borman's, Inc. ("Borman's"). Borman's is a wholly owned subsidiary of The Great Atlantic & Pacific Tea Company, Inc. At the time of trial, Borman's was a public company. It became a wholly owned subsidiary in February, 1989.

The Respondent is the Michigan Property & Casualty Guaranty Association (the "Association"). The Association is not a subsidiary or affiliate of any publicly owned corporation. By law, however, every property/casualty insurer authorized to transact insurance in Michigan, one or more of whom may be publicly owned companies or subsidiaries or affiliates of publicly owned companies, is a member of the Association.

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COUNTERSTATEMENT OF THE CASE

In this rational basis equal protection case, the United States Court of Appeals for the Sixth Circuit held that under the applicable legal standard, the district court should have found as a matter of law that a statutory provision limiting entitlement to certain benefits on the basis of net worth did not violate the Fourteenth Amendment to the United States Constitution. The court of appeals, reviewing the same evidence considered by the district court, concluded that the Michigan legislature rationally could have believed that net worth is a reasonable indicator of a person's relative ability to absorb an unexpected loss occasioned by the insolvency of his or her insurer. Because the district court exceeded its authority in applying the pertinent equal protection test to the legislation before it, the court of appeals reversed and entered judgment in favor of the Respondent Michigan Property & Casualty Guaranty Association (the "Association"). By its Petition for a writ of certiorari, Borman's, Inc. ("Borman's") has asked this Court to review the court of appeals' holding that the district court misapplied the law.

1. Description Of The Association And Of The Legislation Before The Court

The Association is an entity created in 1969 when the Michigan legislature enacted the Property & Casualty Guaranty Association Act (the "Act"), codified in Chapter 79 of the Michigan Insurance Code of 1956, as amended, Mich. Comp. Laws Ann. § 500.7901-§ 500.7949 (West 1983 & Supp. 1991). It is an unincorporated association of

which every insurer (other than insurers transacting only life or disability insurance and certain statutorily-created insurers and insurance funds) must be a member as a condition of its authority to transact insurance in Michigan. *Id.*, § 500.7911 (West Supp. 1991). The Association pays certain policy obligations (called "covered claims") of property/casualty insurers that have been liquidated in receivership proceedings. *Id.*, § 500.7931(1) (West 1983).

The Association funds the payment of covered claims and its administrative expenses through assessments on solvent member insurers. *Id.*, § 500.7941 (West Supp. 1991). Covered claims paid by the Association are allocated to one of five categories: (1) worker's compensation insurance; (2) automobile insurance; (3) title insurance; (4) fire, allied lines, farm owner's multiple peril, homeowner's multiple peril, inland marine, earthquake and credit insurance and (5) all other kinds of insurance except life and disability. The Association is required to assess its members separately for each of these categories, and the assessment for one category may not be used to pay covered claims or related expenses in another category. *Ibid.* The Act limits annual assessments to one percent of the member's net direct premiums written in Michigan during the previous calendar year (*Ibid.*), thus limiting the resources available to the Association for the payment of covered claims.

The 1969 Act provides extensive, although not total, protection for Michigan insureds of insolvent property/casualty insurers and for persons with claims against these insureds. Indeed, consistent with the limited resources available to the Association, the Act reflects a number of public policy-oriented choices which have the

effect of providing full protection to some, incomplete protection to others and none to others still.

For example, the Act includes protection for all lines of property and casualty insurance, including financial guaranty insurance, credit insurance and other lines (*Id.*, § 500.7911), while many other states' guaranty funds do not provide such protection. Additionally, section 7925 of the Act, which defines the "covered claims" the Association is required to discharge, excludes claims for attorney fees, adjustment costs and interest incurred before an insurer's insolvency; excludes claims for unearned premium in excess of $500 (adjusted annually to account for changes in the consumer price index); excludes claims filed after the last date for the filing of claims in the receivership proceedings in the insolvent insurer's domiciliary state; excludes claims of other insurance companies, insurance pools and underwriting associations and excludes claims against the insurer that arise out of an unfair trade practice. *Id.*, § 500.7925 (West 1983). Additionally, section 7925 of the Act limits the total amount of a covered claim in any given year to 1/20 of one percent of the aggregate premiums written by member insurers during the calendar year preceding insolvency (compared with much lower limits in other states), although the Act sets no upper limit on the size of covered worker's compensation claims. *Ibid.* Another example of a policy choice which the legislature made in the Act is found in a collateral source rule that requires the Association to set off benefits or damages recoverable from another source of insurance as a credit against a covered claim (*Id.*, § 500.7931 (West 1983)).

The statutory provision challenged by Petitioner and upheld by the court of appeals – section 7925(3) of the Act – excludes from coverage under the Act obligations of an insolvent insurer to a person whose net worth in the year of the insurer's insolvency exceeds 1/10 of one percent of the aggregate premiums written by Association members in the calendar year preceding the insolvency. *Id.*, § 500.7925(3) (West 1983).[1]

2. Facts Giving Rise To This Lawsuit

From May 1, 1980 through May 1, 1984, Petitioner, which owns among other entities the Farmer Jack supermarket chain, was insured under a general liability policy issued by Ideal Mutual Insurance Company ("Ideal Mutual"). Trial Transcript ("Tr."), 1/9/89, pp. 41-42. Ideal Mutual insured Petitioner for losses up to $1 million in excess of a $50,000 self-insured retention. *Id.*, p. 43.

On August 7, 1980, during the period covered by the Ideal Mutual policy, Norris Frye was injured while shopping in a Farmer Jack supermarket. *Id.*, pp. 44-45. On August 7, 1981, Frye filed a complaint against Petitioner to recover damages for his injury. *Id.*, p. 62. On September 24, 1984, a Wayne County, Michigan jury awarded Frye $1.5 million. *Id.*, p. 45. Eventually Petitioner settled the

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[1] In 1984, the year prior to the insolvency involved in this case, property/casualty insurance writings in Michigan were approximately $4,696,500,000. Thus, the net worth "cutoff" in 1985 was $4,696,500. *Borman's, Inc. v. Michigan Property & Casualty Guaranty Ass'n*, 717 F. Supp. 480 (E.D. Mich. 1989), Appendix to Petition for writ of certiorari (hereafter "App."), p. A-25.

Frye case for $1.15 million. Under the terms of the general liability policy, Ideal Mutual was responsible for $950,000 of the settled-upon sum (its policy limits less Petitioner's self-insured retention). *Id.*, p. 47. Before Frye was paid, however, the New York Supreme Court ordered Ideal Mutual into rehabilitation on December 26, 1984, and enjoined further proceedings against the insurer. The New York court ordered Ideal Mutual liquidated on February 7, 1985. *Id.*, pp. 47-48. After the insolvency, Petitioner paid $1 million toward settlement of the *Frye* case. *Id.*, p. 53.

Petitioner sought payment from the Association of amounts paid to Frye and to several other persons whose claims would have been paid by Ideal Mutual had it remained solvent. Under the authority of section 7925(3), the Association denied coverage because Petitioner's net worth at the end of 1984, the year immediately preceding Ideal Mutual's insolvency, was nearly $24 million, exceeding the $4.7 million cutoff established for 1985 insolvencies by over $19 million. Petitioner's lawsuit arose from the Association's denial of its claims.

3. Course Of This Litigation Below

Petitioner filed this lawsuit for declaratory and monetary relief on January 9, 1986, challenging section 7925(3) under the Equal Protection and Due Process Clauses of the United States and Michigan Constitutions. On December 10, 1987, the district court denied the parties' cross-motion for summary judgment on the constitutional issues, but held that the applicable legal test against which the constitutionality of section 7925(3) is to be

measured is the "rational basis" standard. App., pp. A-40-A-41.

For seven days between January 9 and 24, 1989, the case was tried before United States District Judge Barbara K. Hackett without a jury. On June 30, 1989, the district court issued an opinion and judgment declaring that section 7925(3) of the Act violates Petitioner's equal protection rights under the federal and Michigan Constitutions. *Id.*, p. A-37. In addition, the district court ordered the Association to pay claims which Petitioner had to pay because of Ideal Mutual's insolvency. These claims total approximately $1.2 million. Order Amending Judgment And Opinion, *Id.*, pp. A-15-A-17.

The district court ordered that its judgment apply prospectively only. On July 31 and August 29, 1989, the court amended its judgment to clarify the prospective-application ruling. The court ordered that, except for the $1.2 million in claims noted above and other amounts payable under the Ideal Mutual policy for which Borman's filed a timely claim with the Association, its June 30, 1989 judgment would apply only to claims filed with the Association arising under policies issued by insurers which became insolvent after June 30, 1989.

The Association appealed the trial court's opinion and judgment to the United States Court of Appeals for the Sixth Circuit. In an opinion and by a judgment filed on February 7, 1991, the court of appeals reversed the district court. *Borman's, Inc. v. Michigan Property & Casualty Guaranty Ass'n*, 925 F.2d 160 (6th Cir. 1991). The court of appeals summarized the question before it and the

scope of its holding in the opening paragraph of its opinion:

> This appeal presents the question of whether the district court erred in finding that Mich. Comp. Laws § 500.7925(3), which excludes from coverage certain insureds whose net worth exceeds a statutorily-calculated maximum under the Michigan Property & Casualty Guaranty Act, is not rationally related to a legitimate governmental purpose in violation of the equal protection clause of the United States Constitution and the Michigan Constitution. As we find that the district court exceed its scope of review in assessing the constitutionality of § 500.7925(3), we reverse.

Id., pp. A-1-A-2.

After discussing the applicable equal protection standard (*Id.*, pp. A-4-A-5), which Petitioner and the Association agree applies to this review of socioeconomic legislation, the court of appeals stated the legal issue in this case in the following terms:

> Against this background, we must decide whether the Michigan legislature's determination that net worth was an appropriate means of predicting the ability of a company to absorb unexpected loss was so irrational that no state of facts 'reasonably may be conceived to justify it.'

Id., p. A-5 (quoting from *Baker v. Vanderbilt Univ.*, 616 F. Supp. 330, 331 (M.D. Tenn. 1985), which in turn quotes *McGowan v. Maryland*, 366 U.S. 420, 426 (1961)). The court of appeals held that "within this extremely narrow scope of review, the Michigan legislature's reliance on net worth in § 7925(3) passes constitutional muster." App., p. A-5.

The court of appeals discussed the evidence offered at trial, which the district court conceded was "conflicting," on the question whether net worth is a rational indicator of one's relative ability to absorb losses. *Id.*, p. A-36. Summarizing its discussion, the court of appeals held:

> [w]hile the Association did not by any means prove that net worth was the best mechanism for determining ability to absorb loss, it did put on sufficient evidence to suggest that factual circumstances were conceivable which justify the legislature's use of net worth as a proxy for a more complex calculation. Further, the Association put on evidence to suggest that the net worth standard was much easier to administer than more complex standards. While ease-of-administration, on its own, is not sufficient to justify an otherwise irrational legislative enactment, *United States Dep't of Agriculture v. Murry*, 413 U.S. 508, 513 (1973), it is beyond dispute that the legislature may consider the administrative difficulties of individual eligibility determinations in making 'a substantive policy determination that limited resources would not be well spent in making individual determinations.' *Weinberger v. Salfi*, 422 U.S. 749, 784 (1975).

Id., p. A-7.

On February 18, 1991, Petitioner filed a petition for rehearing and for rehearing *en banc*. This petition raised the same arguments which Borman's makes in its Petition to this Court for a writ of certiorari: (1) that the court of appeals violated Fed. R. Civ. P. 52(a) by failing to follow the district court's "factual findings" in the absence of a determination that such findings were clearly erroneous and (2) that the court of appeals erred in determining in

the face of conflicting evidence that Borman's had not satisfied its burden of overcoming the presumption of constitutionality attaching to section 7925(3).

In an Order filed on March 25, 1991, the court of appeals denied rehearing *en banc* and denied Borman's petition for rehearing. The court of appeals' February 7, 1991 judgment was thus issued as the court's mandate on April 3, 1991. The instant Petition for a writ of certiorari followed.

SUMMARY OF ARGUMENT

This Court's rules caution that "review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only when there are special and important reasons therefor." Sup. Ct. R. 10.1. Borman's Petition plainly fails to satisfy this threshhold requirement. It raises no constitutional questions of any import. Nor is there any issue in this case involving the construction or application of a federal statute. The court of appeals' decision does not conflict with a decision of another United States Court of Appeals (or with a decision of any other court, for that matter). Instead, in a rather unexceptional rational basis case, the court of appeals held that the district court misapplied the law and, contrary to this Court's decisions establishing a very limited scope of review in such cases, improperly substituted its own judgment for that of the Michigan legislature.

Although Petitioner attempts to cast its disagreement with the court of appeals' decision as one involving the

Sixth Circuit's "fail[ure] to give the required deference to the District Court's findings" of fact (Petition, p. 10), this case does not even remotely involve Fed. R. Civ. P. 52(a). The court of appeals reviewed the same testimony as the district court (none of which the district court found to lack credibility). The court of appeals did not "find" any facts. Instead, the court *accepted* the factual record developed before the district court and merely reviewed that record within the limits established by this Court's rational basis equal protection cases (that is, without *weighing* Petitioner's evidence against the Association's or reaching a judgment as to the relative wisdom of using net worth in the Act *vis a vis* a more complex measure of ability to absorb loss). Then, consistent with its statement of the purely legal issue before it, the court of appeals "decide[d] whether the Michigan legislature's determination that net worth was an appropriate means of predicting the ability of a company to absorb unexpected loss was so irrational that no state of facts 'reasonably may be conceived to justify it.' " App., p. A-5.

If this Court sanctions Petitioner's attempt to recast the district court's application of the equal protection test in this case as a "finding of fact," the federal appellate courts, including this one, effectively would be precluded from *ever* reviewing what plainly are a district court's conclusions of law any time the court chooses to call them "findings of fact." Notwithstanding Petitioner's linguistic sleight of hand, it is clear that the court of appeals decided a question of law, not fact, and thus did not exceed the scope of its permissible *de novo* appellate review.

ARGUMENT

I. THE COURT OF APPEALS' DECISION DOES NOT CONFLICT WITH THIS COURT'S DECISIONS CONCERNING FED. R. CIV. P. 52(a) BECAUSE RULE 52(A) DOES NOT APPLY TO THIS CASE, AS THE COURT OF APPEALS REVIEWED AND REVERSED ONLY THE DISTRICT COURT'S LEGAL CONCLUSION ON THE RELEVANT CONSTITUTIONAL QUESTION.

The linchpin of Borman's certiorari Petition is its argument that the court of appeals discarded the district court's findings of fact and made its own findings, allegedly in violation of this Court's prior holdings with respect to Fed. R. Civ. P. 52(a). More specifically, Petitioner's request to this Court to review the court of appeals' decision rests squarely on the notion that the court of appeals was precluded, absent a showing of clear error, from disturbing the district court's conclusion that the Michigan legislature rationally could not have used net worth as a measure of the relative ability to absorb loss. Rule 52(a) is inapplicable here under this Court's prior teachings, and accordingly there is no issue worthy of certiorari.

The Association does not dispute that Rule 52(a) "means what it says." *Bose Corp. v. Consumers Union of United States, Inc.*, 466 U.S. 485, 498 (1984). Under the rule, "findings of fact" made by the district court in an action tried without a jury "shall not be set aside unless clearly erroneous . . . . " It is equally beyond dispute, however, that Rule 52(a) "does not apply to conclusions of law." *Pullman-Standard v. Swint*, 456 U.S. 273, 287 (1982). "Rule 52(a) does not inhibit an appellate court's power to correct errors of law, including those that may

infect a so-called mixed finding of law and fact, or a finding of fact that is predicated on a misunderstanding of the governing rule of law." *Bose Corp., supra* at 501. The district court's legal conclusions, therefore, must be reviewed *de novo* by the appellate court.

The court of appeals held in this case that the district court "exceeded its scope of review" – in other words, erroneously applied the law – "in assessing the constitutionality of § 500.7925(3)" App., p. A-2, and that the district court improperly substituted its judgment for that of the Michigan legislature. *Id.*, p. A-7. This legal conclusion is based on the district court's erroneous attempt to weigh what the court admitted was "conflicting evidence" on the rational relationship issue. As soon as the district court found that the evidence was conflicting (and the court dismissed none of the testimony as incredible), it was bound as a matter of law to conclude that Petitioner had not overcome its heavy burden of proof under the rational basis test. *Minnesota v. Cloverleaf Creamery Co.*, 449 U.S. 456, 464 (1981) (the party challenging the constitutionality of a statute in a rational basis case cannot prevail if the question whether the law is rationally related to a permissible legislative goal is "at least debatable").

This Court has not established a bright-line rule for determining in all instances what is a "finding of fact" and what is a "conclusion of law." *See, Miller v. Fenton*, 474 U.S. 104, 113 (1985).[2] The Court has held, however, in

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[2] This Court's recent decision in *Salve Regina College v. Russell*, ___ U.S. ___, 111 S. Ct. 1217 (1991) is of no help to

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instances where so-called "factual findings" really involve the application of legal principles to the particular circumstances of the case and the underlying legal rule becomes meaningful only in the context of those circumstances, that such "findings" must not be subject to the clearly erroneous standard of Rule 52(a). In *Miller v. Fenton*, for example, this Court held that the question whether a confession is voluntary and thus admissible is a question of law that is reviewable *de novo*. The Court reasoned as follows:

> At least in those areas in which Congress has not spoken and in which the issue falls somewhere between a pristine legal standard and a simple historical fact, the fact/law distinction at times has turned on a determination that, as a

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Petitioner. Contrary to the statement at page 23 of Borman's Petition, the *Salve Regina College* decision did not "[address] the distinction between factual findings and legal conclusions. . . ." Indeed, *Salve Regina College* did not even involve the question whether the lower court properly had applied Fed. R. Civ. P. 52(a).

The issue before the Court in *Salve Regina College* was whether the court of appeals was required to review *de novo* the district court's interpretation of state law or whether a standard of review of such determination similar to Rule 52(a)'s "clearly erroneous" rule should apply. Noting that "[t]he obligation of responsible appellate jurisdiction implies the requisite authority to review independently a lower court's determinations," the Court held that the court of appeals independently should review the district court's determination of state law. 111 S. Ct. at 1221. The Court opined that "[i]ndependent appellate review of legal issues best serves the dual goals of doctrinal coherence and economy of judicial administration." *Ibid.*

> matter of the sound administration of justice, one judicial actor is better positioned than another to decide the issue in question. Where, for example, as with proof of actual malice in First Amendment libel cases, *the relevant legal principle can be given meaning only through its application to the particular circumstances of a case, the Court has been reluctant to give the trier of fact's conclusions presumptive force and, in so doing, strip a federal appellate court of its primary function as an expositor of law.*

474 U.S. at 114 (emphasis supplied). Similarly, in *Bose Corp. v. Consumers Union of United States, Inc., supra,* the Court noted that not all so-called "findings of fact" are subject to review only for clear error. Instead, "findings" which are inextricably tied to the underlying legal rule which gives the findings meaning may be subject to *de novo* review:

> A finding of fact in some cases is inseparable from the principles through which it was deduced. At some point, the reasoning by which a fact is "found" crosses the line between application of those ordinary principles of logic and common experience which are ordinarily entrusted to the finder of fact into the realm of a legal rule upon which the reviewing court must exercise its own independent judgment. Where the line is drawn varies according to the nature of the substantive law at issue. Regarding certain largely factual questions in some areas of the law, the stakes – in terms of impact on future cases and future conduct – are too great to entrust them finally to the judgment of the trier of fact.

466 U.S. at 501, n. 17.

Thus, the district court's "finding" in this case that net worth is not rationally related to a legitimate purpose was freely reviewable by the court of appeals for two reasons. First, the court of appeals was bound to review the finding *de novo* because it is a conclusion on the ultimate *legal* issue in this case – whether any reasonably conceivable state of facts supports the use of net worth as a measure of the relative capacity to absorb loss. Second, the district court's decision was "predicated on a misunderstanding of the governing rule of law." *Bose Corp., supra* at 501. Although the district court found none of the evidence to be incredible, and although the court conceded that the evidence was conflicting, the court nevertheless proceeded to weigh the evidence and decide for itself whether the Michigan legislature *should* have included a net worth cutoff in the Act. Because the district court's "finding" was infected by its error of law, the court of appeals was not required to apply the clearly erroneous standard in Fed. R. Civ. P. 52(a).

Petitioner relies on labels, rather than analysis, to buttress its position that the court of appeals improperly disturbed a "finding of fact." Clearly, however, Petitioner should not be permitted to *call* the district court's determination of the rational relationship issue a "finding of fact" and thereby completely strip the appellate courts of their plenary authority to decide issues of federal law. The court of appeals in this instance did not exceed that authority, and, therefore, Borman's Petition should be denied.

II. THERE IS NO BASIS FOR GRANTING CERTIORARI IN THIS CASE BECAUSE THE COURT OF APPEALS CORRECTLY APPLIED THE SCOPE OF REVIEW REQUIRED BY THIS COURT IN RATIONAL BASIS CASES.

The court of appeals had ample basis in the record to determine that the district court had exceeded the permissible scope of review under the equal protection clause and impermissibly had judged the wisdom of section 7925(3) rather than its rationality. The record before the district court and the court of appeals was replete with evidence of the history and structure of the Act that supports its rationality. Also, the Association called as witnesses at trial qualified experts in accounting, insurance and insurance regulation. All of these witnesses testified that the legislature's use of net worth as an indicator of the relative capacity to absorb loss was rational.

The district court cited this testimony extensively in its opinion, and flatly acknowledged that the evidence on the rationality of the net worth standard was "conflicting." In light of this conflicting credible evidence, the district court was bound under this Court's decisions to undertake no further examination into the Act's rationality. The district court was required at that point to find the Act constitutional and dismiss Petitioner's claim. The district court's failure to do so was an error of law, not fact. The court of appeals merely corrected this error.

A. Under The Rational Basis Test, The District Court Was Not Permitted To Weigh The Admittedly Conflicting Testimony Concerning The Efficacy And Wisdom Of The Legislature's Choices.

This Court has held consistently that review under the Equal Protection Clause's rational basis test is extremely narrow. Under this standard, section 7925(3) is presumed constitutional in the absence of a compelling showing by Petitioner. To satisfy its heavy burden and overcome that presumption, Petitioner was required to negate every reasonably conceivable state of facts justifying the net worth classification. *Minnesota v. Cloverleaf Creamery Co., supra.* In *Cloverleaf Creamery,* this Court stated:

> States are not required to convince the courts of the correctness of their legislative judgments. Rather, 'those challenging the legislative judgment must convince the court that the legislative facts on which the classification is apparently based could not reasonably be conceived to be true by the governmental decisionmaker.' *Vance v. Bradley,* 440 U.S. [93,] 111 [1979]. . . .
>
> Although parties challenging legislation under the Equal Protection Clause may introduce evidence supporting their claim that it is irrational . . . , they cannot prevail so long as 'it is evident from all the considerations presented to [the legislature], and those of which we may take judicial notice, that the question is at least debatable.' [*United States v. Carolene Prods. Co.,* 304 U.S. 144, 153-154 (1938)]. Where there was evidence before the legislature reasonably supporting the classification, litigants may not procure invalidation of the legislation merely by

> tendering evidence that the legislature was mistaken.

449 U.S. at 464.

Moreover, that Petitioner could establish that the net worth standard does not accomplish its intended purpose in all cases – through the use of so-called "typical" examples involving leveraged buyouts and real estate holding companies in which an entity's net worth can change without a corresponding change in its "profitability"[3] – plainly was not enough to overcome Petitioner's heavy burden:

> Even if the classification involved here is to some extent both underinclusive and overinclusive, and hence the line drawn by Congress imperfect, it is nevertheless the rule that in a case like this 'perfection is by no means required.' *Phillips Chemical Co. v. Dumas School Dist.*, 361 U.S. 376, 385 (1960); *accord, San Antonio School Dist. v. Rodriguez*, 411 U.S. 1, 51 (1973). The provision 'does not offend the constitution simply because the classification "is not made with mathematical nicety . . . . "' *Dandridge v. Williams*, 397 U.S. 471, 485 (1970),

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[3] Petitioner's reliance throughout this litigation on these so-called "typical" examples is misleading. There is no evidence in the record or any other reason to believe that any of Petitioner's "typical" situations have any general applicability outside their own specific fact patterns. A "typical" leveraged buyout and a "typical" real estate holding company are not representative of any commercial transaction except for a "typical" leveraged buyout and a "typical" real estate holding company. Petitioner's "typical" examples really are nothing more than examples of some economic situations, but certainly they are not representative of all (nor anything close to a majority of) such situations.

> quoting *Lindsley v. Nat'l Carbonic Gas Co.*, 220 U.S. 61, 78 (1911).

Vance v. Bradley, 440 U.S. 93, 108 (1979) (footnote omitted). A statute does not offend the Constitution merely because it is "unwise or inartfully drawn." *United States R.R. Retirement Bd. v. Fritz*, 449 U.S. 166, 175 (1980). Indeed, the statute may make "rough accommodations – illogical, it may be, and unscientific." *Ibid.*, quoting *Dandridge v. Williams*, 397 U.S. 471, 485 (1970).

Finally, Petitioner's argument that the legislature *could have* measured an insured's relative capacity to absorb loss by using cash flow or liquidity – alone or in conjunction with net worth – or a nebulous term like "financial condition," is not sufficient to establish irrationality under the rational basis test. The many policy choices which the legislature made in establishing the Association and sculpturing the protection it affords, and the wisdom of these choices, are decisions for the legislature to make, not the courts. Where, as the district court found here, the facts supporting the rational relationship are at least debatable, the legislature's judgment must be accepted.

The district court recognized the correct standard, but flat out misapplied it. Based on the record before it, the court of appeals was correct to reverse the district court's judgment.

Petitioner's reliance on *Borden's Farm Prods. Co. v. Baldwin*, 293 U.S. 194 (1934) for the scope of review, and its argument at page 26 of its Petition that the court of appeals violated this Court's holding in *Borden's* by "rel[ying] on conclusions which were not supported by

the facts," miss the mark in at least two significant respects. First, Petitioner misstates the rule in *Borden's*. In that case, the Court was asked to determine the constitutionality under the Equal Protection Clause of legislation which set the wholesale and retail prices of milk sold in New York City by manufacturers with a "well advertised trade name" a minimum of one cent per quart higher than that sold by other manufacturers. In a challenge to the law by a milk producer deemed to have a "well advertised trade name," the trial court – presented only with affidavits and counteraffidavits from both sides – granted the defendant's motion to dismiss Borden' complaint for failure to state a claim.

This Court reversed the trial court's judgment and held that Borden's was entitled to present evidence on its constitutional claims. The Court reaffirmed the settled rule that

> [w]hen the classification make by the legislature is called in question, if any state of facts reasonably can be conceived that would sustain it, there is a presumption of the existence of that state of facts, and one who assails the classification must carry the burden of showing by a resort to common knowledge or other matters which may be judicially noticed, or to other legitimate proof, that the action is arbitrary.

293 U.S. at 209. The Court also held that

> where the legislative action is suitably challenged, and a rational basis for it is predicated upon the particular economic facts of a given trade or industry, which are outside the sphere of judicial notice, these facts are properly the subject of evidence and findings.

Id. at 210.

Borden's thus stands only for the proposition that in a rational basis equal protection case, where the facts supporting the legislative classification cannot be judicially noticed, the party challenging the classification is entitled to an opportunity to overcome its heavy burden of proof by offering evidence in an appropriate proceeding. The Petitioner in *Borden's*, however, never was given a chance to present its evidence to the district court through a trial. This Court thus remanded the *Borden's* case to the district court for further proceedings.

In direct contrast to *Borden's*, Petitioner in the instant case was given the chance to satisfy its burden at trial. Over the course of seven trial days, both sides offered extensive testimony in support of their respective positions. This is all *Borden's* requires, and the court of appeals did nothing in this case to violate the *Borden's* rule.

Second, Petitioner's argument that the court of appeals violated the holding in *Borden's* mischaracterizes the basis for the court of appeals' decision. Although the district court expressly concluded that the evidence on the rational relationship issue was conflicting, that court nevertheless held that Borman's had overcome its heavy burden under the rational basis test. The court of appeals recognized that the district court's holding was a clear misapplication of this Court's rational basis jurisprudence and, supporting its decision with extensive citations to actual testimony in the record, correctly reversed the district court.

B. Credible Evidence Of The History And Structure Of The Act, And The Testimony Of Qualified Experts In Accounting, Insurance And Insurance Regulation Support Its Rationality.

The trial testimony of Elijah Poxson and Dr. George Gottheimer illustrated the reasonably conceivable state of facts connecting net worth and the objectives of the Act which the Michigan legislature could have considered when it adopted the net worth exclusion.

Mr. Poxson was associated with Michigan Mutual Insurance Company, as its general counsel, vice president and then president, from 1959 through 1977. Mr. Poxson's involvement in the legal aspects of the insurance business – including the drafting and monitoring of insurance-related legislation – spans more than 35 years. Tr., 1/13/89, pp. 8-9. Mr. Poxson's testimony was the *only* evidence presented at trial on the history and thinking directly underlying the Michigan Act.

From 1959 through 1974, Mr. Poxson served on the legal committee of the American Mutual Insurance Alliance (the "Alliance"). The Alliance is a trade association of mutual insurance companies interested in all types of issues of importance to the industry. *Id.*, pp. 10-11. Mr. Poxson was an active member of the Alliance's legal committee. *Id.*, p. 11.

Mr. Poxson's testimony confirmed that before the Act was adopted, Michigan insureds (and persons with claims against Michigan insureds) faced with the insolvency of an insurer generally were unprotected from the financial hardships associated with the loss of coverage. Certainly the state provided no such protection. Usually

insureds had no recourse but to stand in line with the remaining unsecured creditors of the insurer and hope to receive a small fraction of the coverage they purchased. *Id.*, p. 19. During the 1960s, a number of insurer insolvencies prompted concern within the Alliance legal committee over the issue of insolvency and, more specifically, over measures which were being considered to address the problem. *Id.*, p. 13.

In the late 1960s, Senator Magnuson proposed legislation in the United States Congress to create a national, pre-insolvency-funded insurance pool to pay covered claims of insureds whose carriers had become insolvent (which would operate much as the FDIC operates with respect to insured banks). *Id.*, p. 20. The pendency of the Magnuson bill prompted the Alliance legal committee to form a subcommittee of three members, including Mr. Poxson, to focus specifically on the issue of guaranty fund legislation. *Ibid.* The result of the subcommittee's discussions was the drafting of a model guaranty association bill in late 1968. The model bill proposed a post-insolvency fund to be administered by the states – which already actively regulated insurance companies – rather than the federal government. *Id.*, pp. 20-21.

In early 1969 the Michigan Insurance Commissioner, which was and is charged by state statute with the enforcement of Michigan's insurance laws and the regulation of the insurance industry in the state, appointed Mr. Poxson to a committee of general counsel from several insurance companies which the Commissioner had formed to address the insolvency issue in Michigan. The Commissioner appointed an actuary from the Michigan Insurance Bureau to chair the committee. The committee

focused at that time on a guaranty fund bill that was pending in the Michigan legislature. *Id.*, pp. 21-23.

The Commissioner's committee studied the pending legislation and concluded that it did not adequately address the problems raised by insurer insolvency. *Id.*, p. 22. The committee considered the Alliance model bill, concluded that it was a better solution to the insolvency problem than the pending legislation, and submitted it as a substitute for the bill then under consideration by the legislature. *Id.*, p. 25. On August 11, 1969, the substitute bill became the Michigan Property & Casualty Guaranty Act.

Mr. Poxson, who drafted the Alliance model bill and was involved with its consideration through the time it was submitted as a substitute bill, explained the development and rationale behind the net worth limitation in the Act:

> Q: Now, could you tell the Court what your rationale was, as one of the co-authors of this bill, for that provision?
>
> A: . . . . I believe that anyone, any person or corporation which had a networth [sic] of a million dollars,[4] in other words the difference between assets minus liabilities, was a person of

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[4] The Alliance model bill contained a flat $1 million net worth cap. The Act as passed indexes the cap so that it fluctuates as inflation affects premium writings in Michigan. The Commissioner's committee found (and subsequent history has confirmed) that the indexing approach is more equitable than a flat $1 million cutoff. Tr., 1/13/89, pp. 49-50.

> substantial wealth and, therefore, would be able to bear a reasonably large, unexpected loss without too much difficulty, even if they were uninsured.

Id., pp. 44-45.

Mr. Poxson testified that in considering how to limit eligibility for the limited coverage to be provided under the Act, the Commissioner's committee considered other measurers of wealth, such as assets, in addition to net worth. *Id.*, pp. 48, 66. The drafters of the Alliance model bill and the Insurance Commissioner's committee rejected the use of assets, however, and decided on net worth. Mr. Poxson testified that the members of the Commissioner's committee felt the use of assets as a measure of one's relative capacity to absorb loss, without also considering corresponding liabilities, was "not representative of a person's ability to respond." *Id.*, p. 66.

In addition to Mr. Poxson, Dr. George Gottheimer, whose academic, professional and teaching experience in such areas as reinsurance and insolvency span 35 years, testified about the concerns in the insurance industry and in state legislatures over the past 20 to 25 years which led to the enactment of guaranty association statutes and the inclusion of net worth provisions. Dr. Gottheimer's undisputed testimony confirmed that the chief concerns of legislators and regulators in the late 1960s, when the Act was passed, and in the early to mid 1980s when several other states enacted guaranty fund legislation with net worth exclusions, were (1) what could be done to protect, at least in part, those in society who are hardest hit by the insolvency of their insurers and (2) given the conceded limits on financial resources, how

those resources should be allocated so they reach those most in need of them. *Id.*, pp. 96, 109.

Dr. Gottheimer opined that, given these concerns, using net worth as a measure of an insured's cushion to absorb unforeseen losses was and is rationally related to the purposes underlying the Act. Tr., 1/17/89, pp. 8, 10.

The testimony of Julius Otten, a partner in the public accounting firm of KPMG Peat Marwick, and an accountant with over 25 years experience dealing with insurance-related issues from an accounting standpoint, also supported the net worth classification. Mr. Otten testified that using net worth as an indicator of financial wealth and the relative capacity to absorb losses is indeed rational:

> I think you can characterize networth [sic] as a – as a cushion, which can be used to absorb losses. Those losses can come from operations. They can come from contingencies, which can't be anticipated but materialize – maybe materialize over time. Certainly within the insurance industry itself, particularly the casualty industry, surplus or networth [sic], if you will, is perceived to be the cushion to absorb adverse losses. . . .

Tr., 1/18/89, p. 17.

Mr. Otten vigorously disagreed with assertions made by Robert Epstein, Borman's general counsel, that there is

no relationship between net worth and the capacity to absorb loss:[5]

> While I could agree different parties might perceive the relationship to vary, there is certainly some relationship at a minimum between net-worth [sic] and the capacity to absorb loss.

Id., p. 10.

Mr. Otten testified that net worth is by itself a useful (though imperfect) indicator of a person's relative capacity to absorb losses. Mr. Otten testified that given this usefulness, it certainly is rational for Michigan's legislature to look at an insured's net worth when seeking to allocate insolvency losses to those best able to absorb them. *Id.*, pp. 10-11. Additionally, Mr. Otten testified that while the legislature could have defined the cutoff by using other indicia of financial condition, such as assets, cash flow or liquidity, none of these measures would be as equitable or administratively workable as net worth. *Id.*, p. 11.[6]

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[5] Indeed, Mr. Epstein's assertion was refuted by the Petitioner's own accounting expert, David Simmons, who conceded on cross examination that net worth does provide at least "information" about an insured's financial condition and its ability to absorb an unexpected loss. Tr., 1/11/89, p. 41.

[6] Contrary to the argument at page 28 of the Petition, the court of appeals did not hold that administrative ease is itself sufficient to support the Act's constitutionality. Quite to the contrary, the court of appeals held, consistent with this Court's past decisions, that the legislature may consider such efficiencies when deciding between two reasonable alternatives. Having decided that under the rational basis test the Act was not irrational, the court of appeals' discussion of the superior administrative workability of the net worth standard as opposed to other reasonable eligibility standards was entirely proper.

Petitioner's general counsel, Robert Epstein, and its accounting expert, David Simmons, agreed on cross examination with Mr. Otten's testimony that, although the truest measure of an insured's ability to withstand unexpected casualty losses is its entire "financial condition," net worth does in fact provide information that can be used to assess financial condition and the relative capacity of an insured to absorb an unexpected loss. Tr., 1/9/89, p. 87; Tr., 1/11/89, p. 41. Neither witness expressed an opinion on the administrative workability of a guaranty fund statute which based eligibility for coverage on an insured's "financial condition."

Jean Carlson, Deputy Commissioner of Insurance for Policy and Compliance in Michigan, also testified in favor of the rationality of the net worth exclusion. Ms. Carlson's testimony is based on her experience and educational background in insurance regulation, economics and public policy issues related to the regulation of the insurance industry in Michigan. Ms. Carlson testified that, faced with the tough policy choices involved in establishing a guaranty fund with limited resources to alleviate some of the financial hardships resulting from insolvency, it was rational for the legislature to use net worth as a means of allocating resources to those most in need of them:

> I think, speaking as an economist and not as an accountant, that I don't know how else I would measure wealth for most people, whether [sic] other than networth [sic]. You know, assets less whatever liabilities or other amounts are owed

> leaves you basically what your – the assets that are left are the ones no one else has a claim against. . . .

Tr., 1/17/89, p. 98.

The evidence offered at trial by the Association's witnesses clearly established that net worth is a good and rational indicator of an insured's (and an insurer's) relative capacity to absorb loss. Indeed, Borman's own witnesses admitted that net worth does provide information about the relative capacity to handle unexpected and uninsured losses. Tr., 1/9/89, p. 87; Tr., 1/11/89, p. 41.

With this substantial body of evidence in front of it, the district court was required to find that Petitioner had not satisfied its burden under the rational basis standard, and that section 7925(3) is constitutional. Its failure to do so was a clear error of law which the court of appeals properly corrected. Petitioner has no basis for further review of that judgment by this Court.

CONCLUSION

For the foregoing reasons, the Petition for a writ of certiorari should be denied.

Respectfully submitted,

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